Economics

THE WEEK AHEAD

April 3 - 7, 2023

The climate of uncertainty

by **Avery Shenfeld** avery.shenfeld@cibc.com

Winston Churchill called democracy the worst political system, except for everything else that's been tried. One of its hallmarks is that the people have the right to change their minds. They can then choose a new party to govern them, or the governing party can alter its own stance to keep pace with voters. But there are times when that flexibility stands in the way of giving enough certainty for long term investment decisions to be effectively made, and that's what's at stake in Canada's drive to meet its commitments on climate change.

South of the border, much of America's opportunity to reduce carbon emissions lies in greening the power generation sector. An expansion of low-carbon electric power capacity will be important here too, if we are to expand its use in transportation and other activities. In the US, and significantly in Canada, we'll be dangling the carrot of tax credits to promote such investments, and future political change won't really matter for projects that already received that subsidy as they were built.

But, as our equity research team pointed out in reviewing this week's federal budget measures, less of Canada's low hanging fruit lies in converting from one source of electric power to another, given our existing reliance on hydro power and nuclear, and lesser use of coal. Instead, a larger share comes from Canada's fossil fuel sector, so it will play a key role in meeting our climate pledges to the rest of the world.

The US isn't shutting down its fossil fuel sector; the Biden administration just went ahead with new drilling leases in the Gulf of Mexico and expanded activity in Alaska. But it's going to earn more of its check marks on climate by trying to catch up to Canada in zero-emission electric power, and subsidizing EVs. Canada will therefore need to do more in its oil and gas sector, and that's where some policy certainty is essential.

Policymakers, working alongside the industry, are promoting carbon capture, utilization and storage (CCUS) as one way to meet those goals. To incent such projects, rather than match the US dollar-for-dollar on upfront subsidies, the intent is to use a mix of carrot and stick. The stick is the carbon tax, which creates an incentive to reduce emissions, and a financial reward for companies that do so, and are able to sell the credits they earn to others who don't have a similarly low-cost way of reducing their emissions and thereby avoid the tax.

The catch is that these financial rewards for carbon capture are paid out over the life of the project, but the business faces the capital costs upfront. Should the voters decide they no longer support a carbon tax, or elect those who opt to slash its rate, there goes the return on the project, since the credits would also be worth less, or worthless in the extreme, to other firms.

In a democracy, no government today can bind all future governments to a particular policy. Ottawa is looking at so-called "contracts for differences" to deal with that problem, since barring a revolutionary overthrow of capitalism, a contract signed by an agency of the federal government during one party's term is still binding on its successors. These contracts would stipulate a floor for the pricing of carbon, so that for the term of the contract, should carbon tax rates end up lower than currently planned and the price of carbon tumble, the government would make up the difference to those taking on a carbon capture project.

That's not really any different than a government ordering up a fleet of naval frigates that will be built well after its term of office. Such contracts bind the next government to carry through on the project or pay up a predetermined fee. Similarly, you can change carbon taxes, as long as those that have entered these contract are duly compensated. That's a necessary ingredient if we're going to get moving on this key area of climate policy, and one that we'll need progress on soon.

Week Ahead Calendar And Forecast—Canada

H, M, L = High, Medium or Low Priority

SAAR = Seasonally Adjusted Annual Rate

Consensus Source: Bloomberg

Date	Time	Economic Releases, Auctions and Speakers	Month	Priority	CIBC	Consensus	Prior
Monday, April 3	10:30AM	BUSINESS OUTLOOK SURVEY	(1Q)	(L)	-	-	0.1
Tuesday, April 4	8:30AM	BUILDING PERMITS M/M	(Feb)	(M)	-	-	-4.0%
Wednesday, April 5	-	AUCTION: 10-YR CANADAS $3.5B	-	-	-	-	-
Wednesday, April 5	8:30AM	MERCHANDISE TRADE BALANCE	(Feb)	(H)	$1.2B	-	$1.9B
Thursday, April 6	8:30AM	EMPLOYMENT CHANGE	(Mar)	(H)	-10K	-	21.8K
Thursday, April 6	8:30AM	UNEMPLOYMENT RATE	(Mar)	(H)	5.1%	-	5.0%
Friday, April 7	-	Markets Closed (Good Friday)	-	-	-	-	-

Week Ahead Calendar And Forecast—United States

H, M, L = High, Medium or Low Priority

SAAR = Seasonally Adjusted Annual Rate

Consensus Source: Bloomberg

Date	Time	Economic Releases, Auctions and Speakers	Month	Priority	CIBC	Consensus	Prior
Monday, April 3	9:45AM	S&P GLOBAL US MANUFACTURING PMI	(Mar)	(L)	-	-	49.3
Monday, April 3	10:00AM	ISM - MANUFACTURING	(Mar)	(H)	47.5	47.6	47.7
Monday, April 3	10:00AM	CONSTRUCTION SPENDING M/M	(Feb)	(M)	-	0.0%	-0.1%
Tuesday, April 4	10:00 AM	FACTORY ORDERS M/M	(Feb)	(M)	-1.0%	-0.5%	-1.60%
Tuesday, April 4	10:00 AM	DURABLE GOODS ORDERS M/M	(Feb)	(H)	-	-	-1.0%
Tuesday, April 4	10:00 AM	DURABLE GOODS ORDERS EX-TRANS M/M	(Feb)	(H)	-	-	0.0%
Tuesday, April 4	10:00 AM	JOLTS Job Openings	(Feb)	-	-	-	10824K
Tuesday, April 4	6:15 PM	Speaker: Loretta Mester (Cleveland) (Non-Voter)	-	-	-	-	-
Wednesday, April 5	7:00 AM	MBA-APPLICATIONS	(Mar 31)	(L)	-	-	2.9%
Wednesday, April 5	8:15 AM	ADP EMPLOYMENT CHANGE	(Mar)	(M)	-	205K	242K
Wednesday, April 5	8:30 AM	GOODS & SERVICES TRADE BALANCE	(Feb)	(H)	-$68.4B	-$68.5B	-$68.3B
Wednesday, April 5	9:45 AM	S&P GLOBAL US SERVICES PMI	(Mar)	(L)	-	-	53.8
Wednesday, April 5	9:45 AM	S&P GLOBAL US COMPOSITE PMI	(Mar)	(L)	-	-	53.3
Wednesday, April 5	10:00AM	ISM - SERVICES	(Mar)	(M)	54.2	54.6	55.1
Thursday, April 6	8:30 AM	INITIAL CLAIMS	(Apr 1)	(M)	-	-	198K
Thursday, April 6	8:30 AM	CONTINUING CLAIMS	(Mar 25)	(L)	-	-	1689K
Thursday, April 6	10:00 AM	Speaker: 10:00 AM James Bullard (St Louis)	-	-	-	-	-
Friday, April 7	8:30 AM	NON-FARM PAYROLLS	(Mar)	(H)	220K	240K	311K
Friday, April 7	8:30 AM	UNEMPLOYMENT RATE	(Mar)	(H)	3.6%	3.6%	3.6%
Friday, April 7	8:30 AM	AVERAGE HOURLY EARNINGS ALL EMPLOYEES M/M	(Mar)	(H)	0.3%	0.3%	0.2%
Friday, April 7	8:30 AM	AVERAGE WEEKLY HOURS ALL EMPLOYEES	(Mar)	(H)	-	34.5	34.5
Friday, April 7	8:30 AM	MANUFACTURING PAYROLLS	(Mar)	(H)	-	10K	-4K

Week Ahead's market call

by Avery Shenfeld

In the **US**, it's much too soon to conclude that we're out of the woods on banking sector concerns, so they remain a potential market driver. But the week ahead also puts the spotlight back on ordinary economic news. Even if payrolls growth decelerates towards our forecast, its still too hot to open up the slack that the Fed wants to see, and a reminder that rate cuts this year aren't in their base case. The JOLTS data hasn't captured what would appear to be a significant drop in job vacancies based on private indicators, but we'll see if that's captured in the its latest readings. The two ISMs aren't likely to move much this month, with the growth tilt still more in services than goods.

In **Canada**, monthly GDP data now point to close to a 3% first quarter, and thereby makes the rush of hiring seen to start the year make just a bit more sense. Still sharply shifting seasonal patterns during the pandemic and mild weather could also have played a role in lifting the first two months of the quarter for seasonally-adjusted growth and hiring, and we therefore see a bit of retreat in employment, and a small uptick in the jobless rate for March. The Bank of Canada's business outlook survey tends to correlate with what's happening during the quarter of the survey rather than what lies ahead. It was softer in the Q4 survey, for example, failing to anticipate the growth uptick in Q1. The Q1 growth bump will likely see some firming in the BOS this time, but again, we don't see it as ruling out a subsequent slowing.

Week Ahead's key Canadian number: Employment—March

(Thursday, 8:30 am)

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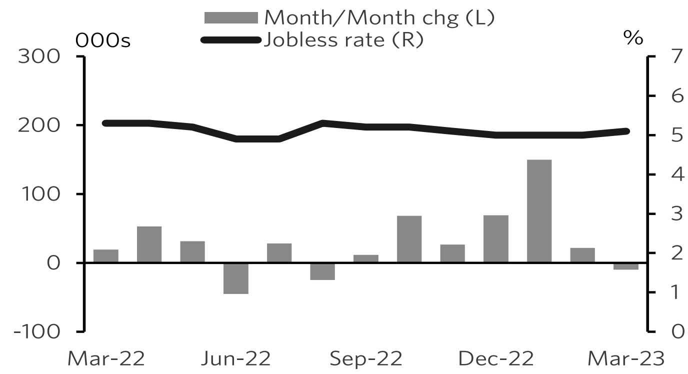
Variable	CIBC	Mkt	Prior
Employment change	-10K	-	21.8K
Unemployment rate	5.1%	-	5.0%

Chart: Employment



Source: Statistics Canada, Haver Analytics, CIBC

We suspect that the surge in employment at the start of 2023 partly reflected reality, as strong population growth helped to fill previously open vacancies, but also partly reflected a statistical illusion as sectors that normally shed staff at the start of any given year did so to a lesser extent. Statistics Canada's updated seasonal factors revised down March readings during the pandemic period, suggesting that the adjustment for this month may be harsher than it was previously. For those reasons, we expect to see a modest decline in employment during March, although that would still leave a very positive underlying trend, as measured by 3 and 6-month averages.

A slight tick down in the participation rate as well is expected to limit the impact that the expected weak employment figure has on the jobless rate, as we see that rising by only one tick to 5.1%. Wage growth should be less volatile now that we are past the comparisons to lockdown periods in 2022, although that's also likely to mean little deceleration from last month's 5½% pace.

Forecast implications — While the decline we expect in March employment could be chalked up to statistical noise, we also anticipate that a weakening economy will bring slower growth in employment than the labour force throughout the remainder of the year, seeing the unemployment rate continuing to drift higher towards 6%.

Other Canadian releases: Merchandise trade—February

(Wednesday, 8:30am)

It appears that some of factors contributing to January's surge in exports and surprise trade surplus reversed in February. Oil prices and export volumes were down, albeit only modestly, and trade within the auto industry appears to have downshifted again. As a result, we see the good trade surplus narrowing from $1.9bn in January to $1.2bn in February.

Week Ahead's key US number: Employment situation—March

(Friday, 8:30 am)

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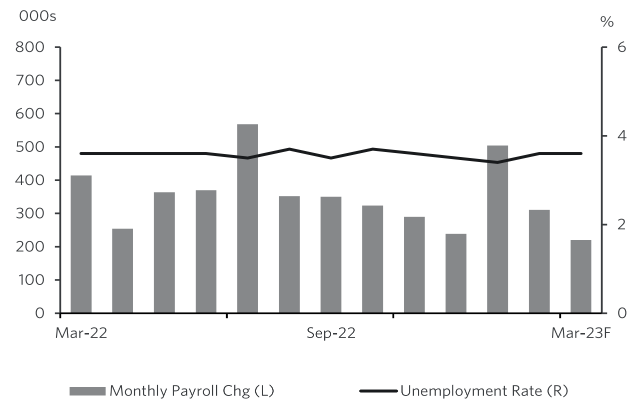
Variable	CIBC	Mkt	Prior
Employment (m/m)	220K	240K	311K
Unemployment rate	3.6%	3.6%	3.6%
Average hourly earnings (m/m)	0.3%	0.3%	0.2%

Chart: Employment



Source: BLS, Haver Analytics, CIBC

Jobless claims remained low in the March payroll survey reference period, signaling a healthy 220K pace of hiring. However, that likely represented a filling of past job openings, rather than new demand for labor, with layoffs in sectors that outperformed during the height of the pandemic providing a source of labor supply. Cyclical sectors could have also slowed hiring, particularly residential construction, reflecting the impact of past rate hikes on demand.

Although the solid pace of employment growth would typically imply a drop in the unemployment rate, we suspect that a further increase in the prime-age participation rate, in line with dwindling excess savings, could have prevented a decline.

Forecast implications — Although our forecast of 0.3% growth in average hourly earnings doesn't preclude reaching on-target inflation, a 220K pace of hiring is roughly double what Powell has suggested is consistent with sustainable on-target inflation, and we therefore continue to expect a final 25bp rate hike ahead, assuming no proliferation of banking sector issues. With private measures of job openings easing, and previously announced layoffs still coming to fruition, we expect to see a further cooling in the pace of hiring ahead, in combination with a deterioration in cyclical sectors, which will likely leave the Fed on pause after the May FOMC.

Market impact — We're a little below the consensus on payrolls, but likely not by enough to put downwards pressure on bond yields, as the fading of banking sector concerns is an overriding factor.

Other US Releases: ISM Manufacturing—March

(Monday, 10:00 am)

The ISM manufacturing index likely sunk further into negative territory in March, with regional indices implying a reading of 47.5. That would likely include a drop in the new orders sub-index, following a surge in the prior month that could have reversed as growth fears spread, leaving the total index a hair above January's level.

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