Economics

THE WEEK AHEAD

July 4-8, 2022

Just one side of the story?

by **Andrew Grantham** andrew.grantham@cibc.com

This week saw Fed Chair Jerome Powell admit to some of the mistakes his Bank, and others, made during the pandemic. Yet while the speedy recovery in demand caught many off guard, he appeared to pin much of the blame still on supply issues. Policymakers are now working to "get smarter" on forecasting the supply side of the economy, because previously "much too much" emphasis had been placed on managing demand.

However, while it is true that supply dynamics have been much more important than is typical during the pandemic-driven recession and recovery, for the US economy more than most others, demand has also played a big role in driving inflation.

On the goods side, it's very easy to see that demand is still excessive relative to pre-pandemic norms. While other countries have seen retail sale volumes return to levels that are broadly consistent with, or even below, a 2% annualized growth rate since the start of the pandemic, that has clearly not happened in the US (Chart left). Increased spending on services as they reopened was not funded through a substitution away from goods as had been expected.

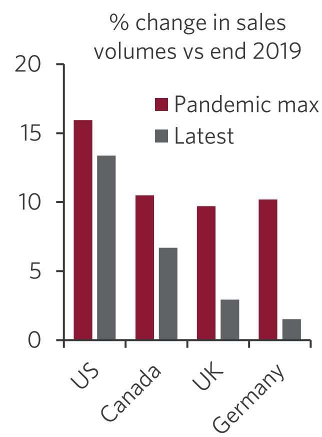
Indeed, it is other countries, including Canada, that seem to have suffered more from supply disruptions. While retail sales volumes haven't been as strong relative to the US, the inventory to sales ratio (viewed as a sign of inflationary pressure) has actually fallen slightly further (Chart right). Bridge blockades, weather events and companies potentially redirecting shipments to fill the insatiable appetite of the US consumer have likely all contributed to that trend.

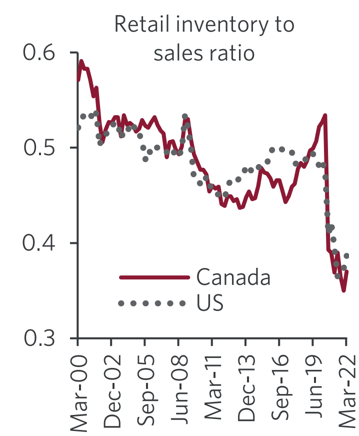
There is even evidence that the US hasn't been hit quite as hard as other countries by labour shortages in key consumer-facing service industries, despite high vacancy rates and an overall labour force participation rate still below its pre-pandemic level. In accommodation & food services, where the cost of labour most directly impacts pricing, total hours worked in the US are still 7% below end-2019 levels, despite a full recovery in demand. However, in Canada hours are down 8.5% on the payrolls survey and an even larger 15% if you trust the labour force numbers. The UK data are also still showing a double-digit decline relative to 2019.

If demand is a bigger factor driving inflation in the US than it is in many other countries, a valid question would then be why aren't we forecasting more rate hikes than the Fed itself? The simple answer is that interest rate increases are not the only factor working to slow the US economy this year, with the turn in fiscal policy and squeeze on disposable incomes from high inflation also weighing. Indeed, a lack of further upward momentum in our reopening index (covering services such as air travel and restaurant bookings) in recent months suggests that demand may already be softening.

While economic activity will likely have to be weaker than the Fed's recently downgraded projections to bring inflation back to target, interest rates shouldn't have to go much above 3% to make that happen.

Chart: US retail sales haven't eased much from pandemic peak (L), Canada has seen just as big a dip in retail inventory-to-sales ratio (R)





Source: BEA, Statistics Canada, CIBC

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, July 4	10:30 AM	BoC Business Outlook Survey & Canadian Survey of Consumer Expectations	-	-	-	-	-
Tuesday, July 5	-	AUCTION: 3-M BILLS $8B, 6-M BILLS $3B, 1-YR BILLS $3B	-	-	-	-	-
Tuesday, July 5	8:30 AM	BUILDING PERMITS M/M	(May)	(M)	-	-	-0.6%
Wednesday, July 6	-	-	-	-	-	-	-
Thursday, July 7	-	AUCTION: 10-YR CANADAS	-	-	-	-	-
Thursday, July 7	8:30 AM	MERCHANDISE TRADE BALANCE	(May)	(H)	$2.8B	-	$1.5B
Thursday, July 7	10:00 AM	IVEY PMI	(Jun)	(L)	-	-	72
Friday, July 8	8:30 AM	EMPLOYMENT CHANGE	(Jun)	(H)	25.0K	-	39.8K
Friday, July 8	8:30 AM	UNEMPLOYMENT RATE	(Jun)	(H)	5.1%	-	5.1%

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, July 4	-	Markets Closed (Independence Day)	-	-	-	-	-
Tuesday, July 5	8:30 AM	FACTORY ORDERS M/M	(May)	(M)	0.6%	0.5%	0.3%
Wednesday, July 6	7:00 AM	MBA-APPLICATIONS	(Jul 1)	(L)	-	-	0.7%
Wednesday, July 6	10:00 AM	ISM - SERVICES	(Jun)	(M)	53.9	54.2	55.9
Wednesday, July 6	10:00 AM	JOLTS Job Openings	(May)	-	-	-	11400K
Wednesday, July 6	2:00 PM	FOMC Meeting Minutes	(Jun 15)	-	-	-	-
Thursday, July 7	8:15 AM	ADP EMPLOYMENT CHANGE	(Jun)	(M)	-	183K	128K
Thursday, July 7	8:30 AM	INITIAL CLAIMS	(Jul 2)	(M)	-	-	-
Thursday, July 7	8:30 AM	CONTINUING CLAIMS	(Jun 25)	(L)	-	-	-
Thursday, July 7	8:30 AM	GOODS & SERVICES TRADE BALANCE	(May)	(H)	-$84.7B	-$85.0B	-$87.1B
Thursday, July 7	1:00 PM	Speaker: Christopher J. Waller (Governor) (Voter)	-	-	-	-	-
Thursday, July 7	1:00 PM	Speaker: James Bullard (President, St Louis) (Voter)	-	-	-	-	-
Friday, July 8	8:30 AM	NON-FARM PAYROLLS	(Jun)	(H)	200K	250K	390K
Friday, July 8	8:30 AM	UNEMPLOYMENT RATE	(Jun)	(H)	3.6%	3.6%	3.6%
Friday, July 8	8:30 AM	AVERAGE HOURLY EARNINGS ALL EMPLOYEES M/M	(Jun)	(H)	0.3%	-0.3%	0.3%
Friday, July 8	8:30 AM	AVERAGE WEEKLY HOURS ALL EMPLOYEES	(Jun)	(H)	-	34.6	34.6
Friday, July 8	8:30 AM	MANUFACTURING PAYROLLS	(Jun)	(H)	-	25K	18K
Friday, July 8	10:00 AM	WHOLESALE INVENTORIES M/M	(May F)	(L)	-	-	2.0%
Friday, July 8	3:00 PM	CONSUMER CREDIT	(May)	(L)	-	-	$38.07B
Friday, July 8	11:00 AM	Speaker: John C. Williams (Vice Chairman, New York) (Voter)	-	-	-	-	-

Week Ahead's market call

by Andrew Grantham

In the **US**, payrolls will likely rise at a more modest pace in June, as indicated by a levelling off of the recovery in consumer services. The services ISM and ADP surveys released earlier in the week could give an advance indication of that expected slowing, while the Fed minutes will provide more information on what spurred policymakers into an even more non-standard sized rate hike at their last meeting.

In **Canada**, employment growth may have been fairly moderate in June, but wage inflation likely accelerated sharply which will keep pressure on the Bank of Canada to enact an even larger 75bp hike at its July meeting. The Bank's surveys of businesses and consumers (Monday) will also be closely watched for signs of whether current high inflation rates are beginning to impact longer term expectations.

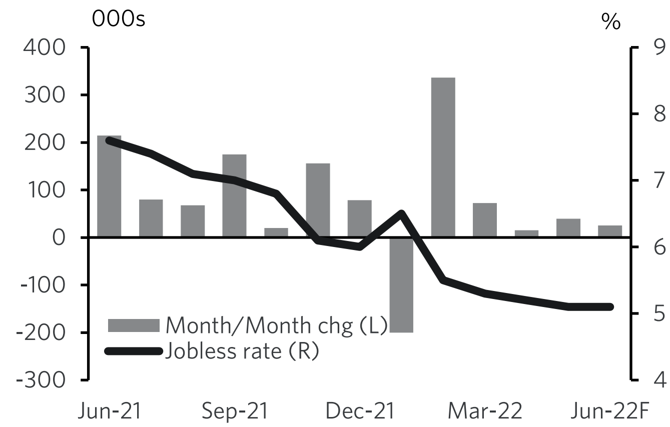
Week Ahead's key Canadian number: Labour force survey—June

(Friday, 8:30 am)

Andrew Grantham andrew.grantham@cibc.com

Variable	CIBC	Mkt	Prior
Employment (m/m)	25.0K	-	39.8K
Unemployment rate	5.1%	-	5.1%

Chart: Canadian employment



Source: Statistics Canada, Haver Analytics, CIBC

Job growth remained solid in May, while wage pressures jumped higher as companies looked to retain staff and fill record vacancies. While employment growth may be lukewarm in June due to ongoing recruitment difficulties and potentially some cooling in construction and real estate, the annual pace of wage inflation will look even hotter. With the late spring 2021 recruiting of low wage workers in leisure and hospitality resulting in a weak year-ago comparison, annual wage growth should top 5% in June.

A more moderate 25K increase in employment would be broadly in line with the pace of population growth and means that, assuming no change in the participation rate, the jobless rate would hold steady at 5.1%.

Forecast implications — While interest rate hikes should start to have a big impact on slowing growth and inflation in the second half of this year and into 2023, the labour market could be more resilient than it has been in the past. Companies may be more reluctant to let go of staff due to the difficulties they had, and are still having, recruiting. Moreover, if staffing levels are reduced in sectors slowing the most due to higher interest rates, some of those workers could end up taking positions in the lower paying services industries where recruiting difficulties have been most prominent.

Other Canadian releases: Merchandise trade—May

(Thursday, 8:30 am)

A rebound in oil prices and volumes likely drove the goods trade surplus wider again in May, after it saw an unexpected narrowing in April. However, with the advance data for manufacturing shipments suggesting a pull back in May, linked anecdotally to the auto sector, that could suggest softness in export volumes outside of energy. In sum we expect a $2.8bn goods trade surplus in May.

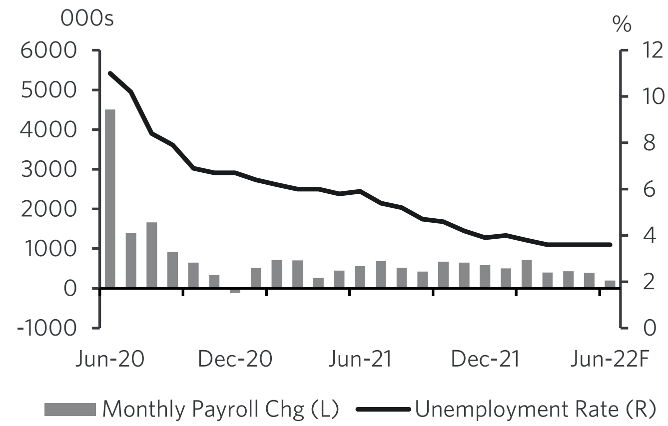
Week Ahead's key US number: Employment situation—June

(Friday, 8:30 am)

Katherine Judge katherine.judge@cibc.com

Variable	CIBC	Mkt	Prior
Employment (m/m)	200K	250K	390K
Unemployment rate	3.6%	3.6%	3.6%
Avg hourly earnings (m/m)	0.3%	0.3%	0.3%

Chart: US payroll employment



Source: BLS, Haver Analytics, CIBC

A slowdown in the interest-sensitive construction and real estate sectors could have combined with worries about domestic demand, as inflation erodes purchasing power, to slow hiring to 200K in the US in June. That slowdown would be consistent with the slight upward trend in initial jobless claims, and the pullback in restaurant traffic over the reference period, as Omicron subvariants spread, as well as the change in seasonal factors earlier in the year that could bias hiring down. With a rise in the participation rate possible, the unemployment rate could have remained at 3.6%, which could also reflect slower job growth in the household survey, as it's closer to its pre-pandemic level than its payrolls counterpart. Wage growth likely continued at a 0.3% monthly pace, well below growth in prices.

Forecast implications — With the unemployment rate remaining low, and the Fed concerned about containing inflation expectations, policymakers will likely remain on track to hike by another 75bps in July, to take the fed funds rate into neutral territory. But by the fall months, we expect to see enough of a trend towards a cooling in activity that officials could slow the pace of tightening.

Market impact — We're below the consensus which could be negative for the USD and see bond yields fall.

Contacts:

Avery Shenfeld
416 594-7356
avery.shenfeld@cibc.com

Benjamin Tal
416 956-3698
benjamin.tal@cibc.com

Andrew Grantham
416 956-3219
andrew.grantham@cibc.com

Karyne Charbonneau
613 552-1341
karyne.charbonneau@cibc.com

Katherine Judge
416 956-6527
katherine.judge@cibc.com

CIBC Capital Markets
PO Box 500
161 Bay Street, Brookfield Place
Toronto, Canada, M5J 2S8
Bloomberg @ CIBC

economics.cibccm.com