Economics

THE WEEK AHEAD

July 3 - 7, 2023

Are rate hikes *really* not working?

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

Last week, the Bank of Canada's "summary of deliberations" showed that there was a healthy debate as to why consumer spending appears unexpectedly strong. That debate included whether excess savings and pent-up demand coming out of the pandemic were disrupting the normal transmission between interest rates and spending, as well as the role of strong population growth and potential seasonal adjustment difficulties.

Ultimately, though, the Bank decided that interest rates must not yet be restrictive enough to sufficiently curb demand, which led to the 25bp hike that was delivered earlier in the month. However, there is one more explanation. It is possible that past rate hikes are already having a bigger impact on demand than perceived, but we are focusing too much on growth rates rather than the level of spending.

Focussing on recent growth rates, it's easy to come to the conclusion that rate hikes haven't bitten into consumer spending plans yet. Indeed, inflation-adjusted spending on items that are usually considered most sensitive to interest rates has risen by almost 15% since the first hike was delivered last year (Chart left). The last time interest rates were increased in 2017/18 (and a lot more gradually), spending on these items had already started to slow.

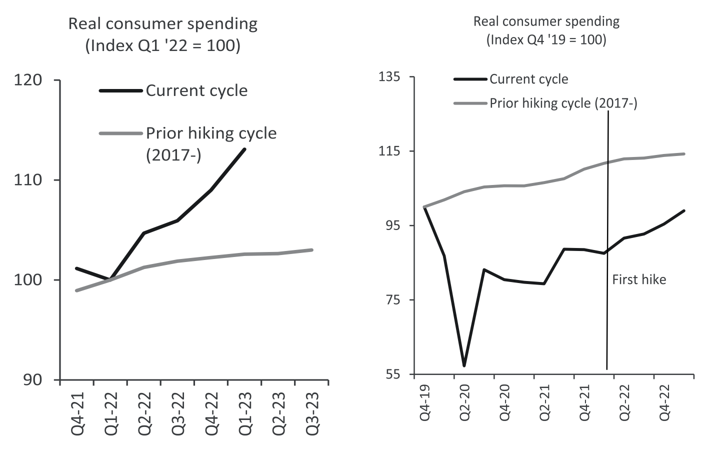
However, looking at the level relative to 2019 tells a very different story, with the volume of spending in these interest rate sensitive areas still 1% below Q4 '19 levels. That would obviously be even worse in per-capita terms, given the strong population growth seen recently, and represents a roughly 10-15% shortfall relative to its pre-pandemic trend (Chart right).

Spending in normally interest rate sensitive sectors includes areas that were hardest hit by either pandemic-related restrictions (travel, restaurants) or supply chain issues (autos). Classifying recent growth in such spending as pent-up demand would be a bit misleading, as households aren't on average eating out more often or going on an extra vacation to make up for the pandemic years. Rather, it is simply a normalisation of activity following a very abnormal period.

While supply issues are certainly still hampering spending to some extent, with airlines, restaurants and other service providers still trying to recruit staff, and car dealers still working through unfilled orders, these issues are improving and may no longer entirely account for the shortfall in spending in such areas relative to their pre-pandemic trend. In other words, rate hikes may already be working to slow demand, and the true test in terms of growth rates is still to come.

If rate hikes have already been working to cool demand more than is apparent by simply looking at growth rates, history could show that the recent Bank of Canada rate hike (and any subsequent moves) was at best unnecessary, and at worst a mistake.

Chart: Normally interest rate sensitive consumer spending has been unusually strong (L), or has it (R)?



Source: Statistics Canada, CIBC *Interest rate sensitive areas include; household appliances, furniture, autos, travel services, restaurants.

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 3	-	Markets Closed (Canada Day)	-	-	-	-	-
Tuesday, July 4	-	AUCTION: 3-M BILLS $11.6B, 6-M BILLS $4.2B, 1-YR BILLS $4.2B	-	-	-	-	-
Wednesday, July 5	-	AUCTION: 5-YR CANADAS $5B	-	-	-	-	-
Thursday, July 6	8:30 AM	MERCHANDISE TRADE BALANCE	(May)	(H)	$1.2B	-	$1.9B
Friday, July 7	8:30 AM	EMPLOYMENT CHANGE	(Jun)	(H)	20K	-	-17.3K
Friday, July 7	8:30 AM	UNEMPLOYMENT RATE	(Jun)	(H)	5.2%	-	5.2%
Friday, July 7	10:00 AM	IVEY PMI	(Jun)	(L)	-	-	53.5

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 3	9:45 AM	S&P GLOBAL US MANUFACTURING PMI	(Jun)	(L)	-	-	46.3
Monday, July 3	10:00 AM	ISM - MANUFACTURING	(Jun)	(H)	47.5	47.1	46.9
Monday, July 3	10:00 AM	CONSTRUCTION SPENDING M/M	(May)	(M)	-	0.4%	1.2%
Tuesday, July 4	-	Markets Closed (Independence Day)	-	-	-	-	-
Wednesday, July 5	10:00 AM	FACTORY ORDERS M/M	(May)	(M)	0.9%	0.6%	0.4%
Wednesday, July 5	10:00 AM	DURABLE GOODS ORDERS M/M	(May)	(H)	-	-	1.7%
Wednesday, July 5	10:00 AM	DURABLE GOODS ORDERS EX-TRANS M/M	(May)	(H)	-	-	0.6%
Wednesday, July 5	2:00 PM	FOMC Meeting Minutes	(Jun 14)	-	-	-	-
Wednesday, July 5	4:00 PM	Speaker: John C. Williams (Vice Chairman, New York) (Voter)	-	-	-	-	-
Thursday, July 6	7:00 AM	MBA-APPLICATIONS	(Jun 30)	(L)	-	-	3.0%
Thursday, July 6	8:15 AM	ADP EMPLOYMENT CHANGE	(Jun)	(M)	-	250K	278K
Thursday, July 6	8:30 AM	INITIAL CLAIMS	(Jul 1)	(M)	-	-	239K
Thursday, July 6	8:30 AM	CONTINUING CLAIMS	(Jun 24)	(L)	-	-	1742K
Thursday, July 6	8:30 AM	GOODS & SERVICES TRADE BALANCE	(May)	(H)	-$68.9B	-$68.3B	-$74.6B
Thursday, July 6	9:45 AM	S&P GLOBAL US SERVICES PMI	(Jun)	(L)	-	-	54.1
Thursday, July 6	9:45 AM	S&P GLOBAL US COMPOSITE PMI	(Jun)	(L)	-	-	53.0
Thursday, July 6	10:00 AM	JOLTS Job Openings	(May)	-	-	-	10103K
Thursday, July 6	10:00 AM	ISM - SERVICES	(Jun)	(M)	50.8	51.2	50.3
Thursday, July 6	8:45 AM	Speaker: Lorie K. Logan (Dallas) (Voter)	-	-	-	-	-
Friday, July 7	8:30 AM	NON-FARM PAYROLLS	(Jun)	(H)	185K	200K	339K
Friday, July 7	8:30 AM	UNEMPLOYMENT RATE	(Jun)	(H)	3.7%	3.6%	3.7%
Friday, July 7	8:30 AM	AVERAGE HOURLY EARNINGS ALL EMPLOYEES M/M	(Jun)	(H)	0.3%	0.3%	0.3%
Friday, July 7	8:30 AM	AVERAGE WEEKLY HOURS ALL EMPLOYEES	(Jun)	(H)	-	34.3	34.3
Friday, July 7	8:30 AM	MANUFACTURING PAYROLLS	(Jun)	(H)	-	5K	-2K

Week Ahead's market call

by Katherine Judge and Andrew Grantham

In the **US**, we'll get the first readings on June activity, with the payrolls data on Friday likely to show a slowdown in hiring, but not by enough to sway the Fed away from hiking by 25bps in July. Policymakers will also be looking for a resumption of the downtrend in job openings, while the ISM Services index could have ticked up but remained in the low end of the range seen over the past year.

In **Canada**, focus turns to the labour force survey, where we expect to see some further signs of an easing in labour market conditions. While a rebound in employment could keep the jobless rate steady at 5.2%, that would still be off the lows seen earlier in the year. Moreover, we expect to see other signs of weakening from hours worked and a continued rise in those working part time but seeking a full time position.

Week Ahead's key Canadian number: Employment—June

(Friday, 8:30 am)

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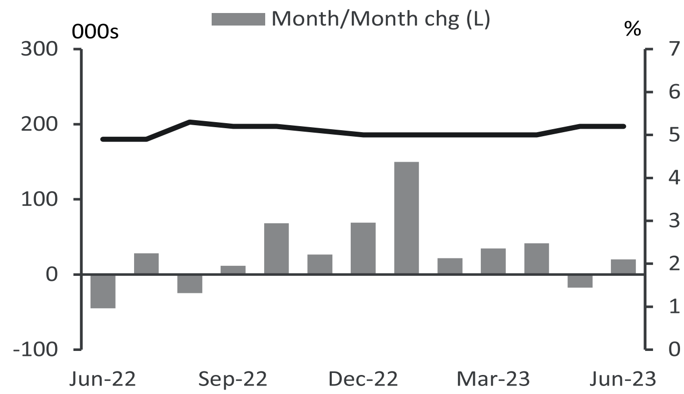
Variable	CIBC	Mkt	Prior
Employment change	20K	-	-17.3K
Unemployment rate	5.2%	-	5.2%

Chart: Canadian employment



Source: Statistics Canada, Haver Analytics, CIBC

The prior month's surprise decline in the job count was largely driven by the youngest age range – a group for which employment trends can be volatile at this time of year. As such, we expect a modest rebound of 20K in June which, with a slight recovery in participation as well, would keep the unemployment rate steady at 5.2%. Wage growth could have edged down slightly, but will have remained firm at around 5% y/y. Hours worked have been starting to lag the trend in employment again recently, partly because excess hours lost due to illness have been climbing again, and that trend could have continued into June.

Forecast implications — While a rebound in June may be enough to prevent the unemployment rate rising further, the underlying trend within the labour market still appears to be weakening. We continue to expect that job growth for the remainder of the year will fall short of the rapid increase in population, seeing the jobless rate climb to around 6% by year-end.

Other Canadian releases: Merchandise trade—May

(Thursday, 8:30 am)

Lower prices likely weighed on oil exports in May, while the impact of wildfires may have disrupted export volumes for other commodities. We expect that the trade surplus narrowed to $1.2bn in May, from $1.9bn in the prior month.

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

(Friday, 8:30 am)

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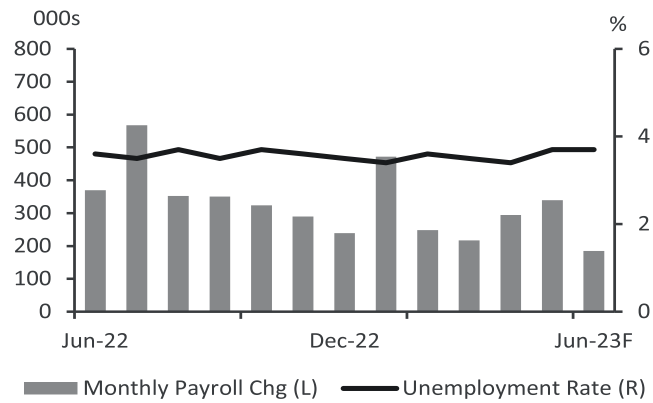
Variable	CIBC	Mkt	Prior
Employment (m/m)	185K	200K	339K
Unemployment rate	3.7%	3.6%	3.7%
Avg hourly earnings (m/m)	0.3%	0.3%	0.3%

Chart: US payroll employment



Source: BLS, Haver Analytics, CIBC

Initial jobless claims jumped in early June, suggesting that hiring could have slowed to a 185K pace over the month. That's also in line with the decline in aggregate hours worked seen in several industries lately including information, manufacturing, retail trade, and transportation and warehousing. The household survey showed a sizable drop in jobs in May and a return to job growth in that survey would keep the unemployment rate at 3.7%, in line with potentially more progress in participation in the core 25-54 age group, which would have also left room for further job gains without additional wage pressures.

Forecast implications — With job openings still elevated, laid off workers are likely still being re-absorbed into the labor market relatively swiftly, but the uptrend in jobless claims and the deterioration in hours worked in several industries are early signs of a slowdown building. With hiring still above the pace of population growth in the core working age group, the Fed will remain on track for two final 25bp rate hikes.

Market impact — We're below the consensus on hiring which could put pressure on bond yields.

Other US Releases: ISM Manufacturing—June

(Monday, 10:00 am)

Moves in regional PMIs suggest that the ISM's manufacturing index rose to 47.5 in June, leaving it in contractionary territory for the eighth month in a row, as cyclical areas of the economy remain under pressure from higher interest rates.

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