Economics

THE WEEK AHEAD

March 6-10, 2023

Monkey see, monkey not do

by Avery Shenfeld avery.shenfeld@cibc.com

A central banker's word is their bond, at least if they want to have markets take heed the next time they try to provide guidance on what lies ahead. So having pledged to pause on rate hikes to see how things unfold, Governor Macklem has little choice but to keep Canada's policy rate unchanged when the Bank of Canada meets in the week ahead. Yes, there were conditions applied to that pause and warnings that hikes might resume, but only if there were evidence that the economy was diverging from the Bank's forecast. A month or so of data can hardly be deemed to be sufficient to reach such a conclusion.

Still, the market isn't at this point convinced that this will be a lasting pause, and the Governor has shared his own doubts. In part, that's a reaction to the upside surprise we saw in January's employment data, which along with a rebound in GDP for that month, points to a renewal of growth to start the year. That said, while Q1 growth is likely to top the last BoC forecast, that won't fully offset the downside surprise registered in Q4 data released this past week, and inflation also came in below expectations.

Markets are also somewhat fixated on the idea that if they have reason to ratchet up their expectations for Fed rate hikes this year, there will be pressure on the Bank of Canada to at least partially keep pace with its American counterpart. In contrast, our view is that the Bank has room to stay on hold even if the ceiling on the US fed funds rate gets through 5.5%.

True, looking over past business cycles, policy rates often move broadly in the same direction. But that largely reflects the strong correlation between business cycles in the two economies. Once you zoom in on the wiggles in rates within those cycles, Canada's central bankers are far from "monkey see, monkey do" followers. As we've seen in the past, including at the peak of the last rate cycle where the US pressed on after Canada paused in 2018, there's plenty of elbow room for the Bank of Canada to diverge from decisions south of the border when conditions warrant.

That's exactly where we are today. Monetary policy needn't tighten as far in Canada as what might prove necessary stateside. Household debts and debt service costs are higher in Canada, and more impacted by interest rate changes due to the lack of long-term locked in mortgages. Moreover, neither wages nor prices look quite as hot in Canada.

Where interest differentials can start to matter is through their impact on the exchange rate, since a weaker Canadian dollar is effectively an easing in monetary conditions, and a source of upward pressure on import prices. But the market is already pricing-in a roughly 70 bp differential between US and Canadian peak overnight rates. Even if that stretched out another quarter point, it likely would mean a very modest exchange rate impact.

Moreover, US hikes, by pushing up Canadian term rates, are providing an offsetting tightening in overall monetary conditions here, impacting five year mortgages, for example. The Fed's intention to hike far enough to cool demand in Canada's key trading partner will also do some of the work for our central bank.

No doubt, the Bank of Canada, while leaving rates on hold in the week ahead, will want to remind investors that the pause is still conditional on seeing the economy track in line with its last forecast. This is still a hawkish pause, in effect. But it's also a made-in-Canada pause that will be less influenced by the Fed than many think.

We'll need to see some combination of declining job vacancies, or rising unemployment, for the central bank to be convinced that the deceleration underway in inflation will extend into 2024. But the lagged impacts of rate hikes, already evident in the drop in housing activity, weakening corporate profits and rising household debt service burdens, should give them that evidence in the months ahead.

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, March 6	10:00 AM	IVEY PMI	(Feb)	(L)	-	-	60.1
Tuesday, March 7	-	AUCTION: 3-M BILLS $, 6-M BILLS $, 1-YR BILLS $	-	-	-	-	-
Tuesday, March 7	-	Manitoba Budget 2023	-	-	-	-	-
Wednesday, March 8	8:30 AM	MERCHANDISE TRADE BALANCE	(Jan)	(H)	$0.2B	-$0.2B	-$0.16B
Wednesday, March 8	10:00 AM	BANK OF CANADA RATE ANNOUNCE.	(Mar 8)	(H)	4.50%	4.50%	4.50%
Thursday, March 9	1:45 PM	Speaker: Carolyn Rogers (Sr. Deputy Gov.)	-	-	-	-	-
Friday, March 10	8:30 AM	EMPLOYMENT CHANGE	(Feb)	(H)	5.0K	2.5K	150.0K
Friday, March 10	8:30 AM	UNEMPLOYMENT RATE	(Feb)	(H)	5.1%	5.1%	5.0%
Friday, March 10	8:30 AM	CAPACITY UTILIZATION	(4Q)	(L)	-	-	82.6%

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, March 6	10:00 AM	FACTORY ORDERS M/M	(Jan)	(M)	-2.0%	-1.5%	1.80%
Tuesday, March 7	-	AUCTION: 3-YR TREASURIES $40B	-	-	-	-	-
Tuesday, March 7	3:00 PM	CONSUMER CREDIT	(Jan)	(L)	-	$25.0B	$11.56B
Tuesday, March 7	10:00 AM	Senate Banking Panel Hears Semi-Annual Monetary Policy Report	-	-	-	-	-
Tuesday, March 7	10:00 AM	Speaker: Jerome H Powell (Chairman) (Voter)	-	-	-	-	-
Wednesday, March 8	-	AUCTION: 10-YR TREASURIES $32B	-	-	-	-	-
Wednesday, March 8	7:00 AM	MBA-APPLICATIONS	(Mar 3)	(L)	-	-	-5.7%
Wednesday, March 8	8:15 AM	ADP EMPLOYMENT CHANGE	(Feb)	(M)	-	200K	106K
Wednesday, March 8	8:30 AM	GOODS & SERVICES TRADE BALANCE	(Jan)	(H)	-$68.7B	-$69.0B	-$67.4B
Wednesday, March 8	10:00 AM	JOLTS Job Openings	(Jan)	-	-	-	11012K
Wednesday, March 8	10:00 AM	Speaker: Jerome H Powell (Chairman) (Voter)	-	-	-	-	-
Thursday, March 9	-	30-YR AUCTION: $18B	-	-	-	-	-
Thursday, March 9	8:30 AM	INITIAL CLAIMS	(Mar 3)	(M)	-	200K	190K
Thursday, March 9	8:30 AM	CONTINUING CLAIMS	(Feb 25)	(L)	-	-	1655K
Thursday, March 9	10:00 AM	Speaker: 10:00 AM Michael S Barr (Governor) (Voter)	-	-	-	-	-
Friday, March 9	8:30 AM	NON-FARM PAYROLLS	(Feb)	(H)	205K	200K	517K
Friday, March 9	8:30 AM	UNEMPLOYMENT RATE	(Feb)	(H)	3.4%	3.4%	3.4%
Friday, March 9	8:30 AM	AVERAGE HOURLY EARNINGS ALL EMPLOYEES M/M	(Feb)	(H)	0.3%	0.3%	0.3%
Friday, March 9	8:30 AM	AVERAGE WEEKLY HOURS ALL EMPLOYEES	(Feb)	(H)	-	34.6	34.7
Friday, March 9	8:30 AM	MANUFACTURING PAYROLLS	(Feb)	(H)	-	10K	19K
Friday, March 9	2:00 PM	TREASURY BUDGET	(Feb)	(L)	-	-	-$38.8B

Week Ahead's market call

by Avery Shenfeld

In the **US**, January payrolls gains got a one-time boost from mild weather, but may also have made inroads into filling previously vacant positions. If that's what shows up in JOLTS data on Wednesday, it would suggest that the consensus is reasonable in expecting a deceleration in hiring in February, but jobless claims data haven't signaled any climb in the unemployment rate yet. A 0.3% rise in wages would help cement the case that the labour market's contribution to inflation has eased off.

In **Canada**, employment gains in the last several months looked extremely outsized relative to the pace of GDP, suggesting that here too, they were about filling vacant positions with the help of a surge in immigration, rather than capturing newly generated labour demand. On that theory, we're expecting minimal job gains in the February data and a small uptick in unemployment. As we discuss in the cover, the Bank of Canada is a near lock to leave rates unchanged this month, but will retain language indicating that the pause is conditional on seeing the economy track in line with the Bank's expectations.

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

(Friday, 8:30 am)

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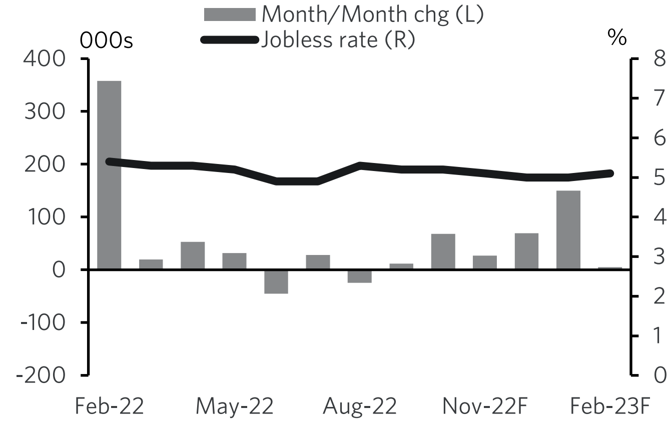
Variable	CIBC	Mkt	Prior
Employment (m/m)	5.0K	2.5K	150.0K
Unemployment rate	5.1%	5.1%	5.0%

Chart: Canadian employment



Source: Statistics Canada, Haver Analytics, CIBC

There are plenty of reasons to suspect that January's surge in employment will have cooled significantly in February. Firstly, job growth has been vastly outpacing that of GDP recently. Secondly, seasonal adjustment difficulties post-pandemic could have contributed to January's surge. Thirdly, the main sectors contributing to an increase in seasonally adjusted employment last month still reduced headcount in unadjusted terms, just not to the same extent as normal possibly due to past recruitment difficulties. Whatever the reason for January's surge, we suspect that employment will only inch up by 5K in February and that the unemployment rate will tick up to 5.1%. Wage growth will look stronger this month, thanks to a weaker comparison from a year ago as low-wage hospitality workers were rehired following the short-lasting shutdown measures in January 2022.

Forecast implications — The Canadian economy has decelerated to a pace below its long-run potential, and employment trends in the coming months are likely to reflect that. Job growth that is below the pace of population growth, or even a few months of job losses, will likely see the unemployment rate rise to nearly 6% by year-end before interest rate cuts and an acceleration in economic growth in 2024 see the jobless rate start to edge down again.

Other Canadian releases: Merchandise trade—January

(Wednesday, 8:30 am)

The Canadian trade balance could move back into surplus territory for the first time in three months in January, with a rebound in oil export volumes and a slight price increase in that area offsetting some weaker prices for other commodities. Imports could have also continued to struggle given the inventory rebuilding already seen and a slowdown in consumer purchases of goods. We forecast a modest $0.2bn surplus for January.

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

(Friday, 8:30 am)

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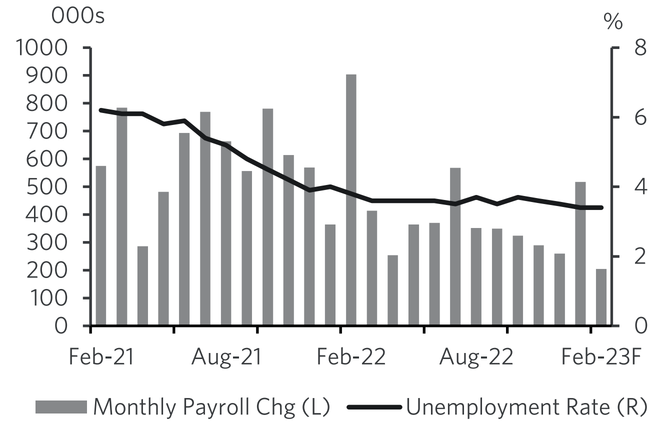
Variable	CIBC	Mkt	Prior
Employment (m/m)	205K	200K	517K
Unemployment rate	3.4%	3.4%	3.4%
Avg hourly earnings (m/m)	0.3%	0.3%	0.3%

Chart: US payroll employment



Source: BLS, Haver Analytics, CIBC

Jobless claims were little changed over the February employment survey reference period, while the Conference Board's survey showed that jobs were still plentiful, and we therefore expect a brisk pace of hiring to have created 205K jobs in February. An improvement in the weather in January likely overstated job gains at the start of the year, and adds downside risk to February's print. We expect the unemployment rate to remain at 3.4%.

We suspect that January's surge in hiring represented a filling of job openings rather than new demand for labor, with layoffs in sectors that outperformed during the height of the pandemic providing a new source of labor supply. If that's true, lower job openings ahead, as implied by the downtrend in private job vacancy measures, would be consistent with a deceleration in hiring in February, in combination with pressure on cyclical sectors that are slowing in response to higher interest rates.

Forecast implications — A 205K pace of hiring is still well above what would satisfy the Fed's desire to add slack to the labor market, leaving policymakers on track for at least another two 25bp rate hikes ahead.

Market impact — We're roughly in line with the consensus expectation, which could limit any market reaction.

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