WEEKLY COMMENTARY

Can Canada's Energy Sector Really Capitalize on Current Events?

By Jimmy Jean, Vice-President, Chief Economist and Strategist

It took the invasion of Ukraine, but it's now clear just how dependent Europe is on Russian energy. In many respects, the EU—and Germany in particular—failed to heed the warning signs. Eight years ago, Vladimir Putin annexed Ukraine's Crimean Peninsula. Germany nonetheless increased its energy imports from Russia in the wake of this event, as it was eager to substitute for coal and nuclear power. Former Chancellor Angela Merkel even oversaw construction of the contentious Nord Stream 2 pipeline. The natural gas pipeline would have doubled Russia's supply capacity to Germany, further tightening Putin's energy stranglehold on Europe. While the pipeline has been complete since September 2021, German authorities halted certification in the wake of the invasion.

This week, one senior US official declared Nord Stream 2 dead. That's probably not an exaggeration. Europe's dependence on Russian energy has softened the blow of sanctions. Even though the US and UK joined Canada in banning Russian oil imports this week, they don't get much of their energy from Russia. Europe does. That's in part why the SWIFT ban in late February had to be tailored to ensure Europe could pay Russia for its gas. But protecting European energy imports has come at a steep cost—essentially funding Putin's aggression.

The invasion of Ukraine is likely a turning point in European energy security. But it's uncertain how exactly the landscape will shift. Climate change adds an additional layer of complexity. Current events notwithstanding, we can't lose sight of the fact that the planet is warming. But the transition to renewable energy will take many years, even if we fast-track it. In the meantime, Europe will have to increasingly depend on undesirable sources like coal to compensate for the lack of natural gas. Italy is looking at reviving coal-fired power plants, and Germany has suggested it could extend its 2030 deadline to shut down coal plants.

Could Canada help solve this conundrum? Despite Canada's decarbonization pledges, there seems to be a lot of domestic political will to help Europe. Europe burning natural gas from Canada instead of Russia wouldn't add to emissions. In fact, it would reduce them if Europe stopped using coal. Moreover, some have advocated for natural gas as a transition fuel, which would also support the production of clean fuels like hydrogen. As our energy research team has pointed out, Canada is one of the top 5 natural gas producers globally. Canada also ranks significantly higher than Russia and many other countries on a number of environmental, social and governance (ESG) indicators. And importantly, Canadian natural gas is relatively low in methane emissions. According to the Intergovernmental Panel on Climate Change, the global warming potential of methane is an estimated 84 times greater than that of CO_2. For all these reasons, Canada could easily be a preferred provider of European natural gas.

But that's where the optimism ends. Logistically, there's very little near-term prospect for Canada to make a difference. Canada currently has no liquid natural gas (LNG) terminals. The Kitimat LNG plant in British Columbia will not begin exporting gas until 2025 and will focus on Asian markets rather than Europe. Meanwhile, recent proposals to bring Canadian natural gas to European markets from the East Coast have struggled to secure financing, regulatory approval and public support. Even assuming a sudden paradigm shift in the wake of the Russian invasion, the first shipments would be several years away.

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Looking beyond, if natural gas does prove to be a transition fuel, global demand will eventually decline. That could happen because cheap sources of renewable energy become widely available, because governments ramp up carbon taxes or both. Such possibilities have inhibited investment in new LNG terminals in recent years. So despite the current geopolitical stakes, it's far from clear that producers' long-term worldview has changed. As a result, we're skeptical that current events will transform the Canadian energy sector's investment outlook.

Week in Review

By Benoit P. Durocher, Senior Economist, Francis Généreux, Senior Economist, Lorenzo Tessier-Moreau, Senior Economist, and Hendrix Vachon, Senior Economist

- **U.S. inflation rose again last month**, from 7.5% in January to 7.9% in February. It was just 1.7% a year ago. Energy played a major role in the consumer price index (CPI) increase in February. The monthly variation in gasoline prices jumped 6.6% and the monthly variation in fuel oil prices was 6.7%. It is clear that the pressure from energy prices will continue to be very strong in March. The war in Ukraine has led to a jump in crude oil prices on the international markets, and this has already impacted gasoline prices. Excluding energy and food, the core CPI advanced 0.5% in February, just shy of the 0.6% for the past two months. That said, the factors driving inflation remain and are also being exacerbated by what is happening in Eastern Europe. The peaks in total inflation and core inflation expected in the coming months should turn out to be higher than recent expectations.
- **U.S. household confidence declined again in March** according to the University of Michigan index, which fell from 62.8 to 59.7, its lowest level since September 2011. The decline came mostly from household expectations (-5 points), which is a negative sign for consumer spending trends.
- **The U.S. balance of trade deteriorated significantly in January.** The deficit hit a new record, climbing from US$82.0B in December to US$89.7B in January. Nominal exports were down 1.7%, and imports grew 1.2%. The deterioration can also be seen in the balance of trade in goods expressed in real terms. Thus, real net exports should lead to a negative contribution to real GDP at the start of the year, leading to a downward revision of the growth forecast for the first quarter.
- **Inflation remains moderate in China.** Annual consumer price growth was just 0.9% in February, a net contrast with the increases seen in North America and Europe. An important difference with what is happening here is that the cost of food (-3.9%), and particularly meat (-26.0%), has been driving Chinese inflation downwards.
- **In Canada, merchandise trade balance strongly improved in January**, from -$0.69B to +$2.62B. This gain is explained by imports dropping much more rapidly (-7.4%) than exports (-1.7%).
- **The Canadian labour market added 336,600 jobs in February**, following a decrease of 200,100 in January. The unemployment rate fell from 6.5% to 5.5%, below its 5.7% pre-pandemic reading and near the 5.4% historic low recorded in May 2019. The labour market is in excellent shape, so the Bank of Canada should continue to normalize monetary policy over the coming months.
- **The Canadian household debt ratio rose to 186.23% in the fourth quarter of 2021**, which is a new all-time high. Mortgages still represent the bulk of the increase in debt during the period.
- **The financial markets remained highly volatile this week.** The S&P 500 posted its strongest daily decline since October 2020 on Monday while the cost of WTI (West Texas Intermediate) oil approached US$130 per barrel on Tuesday. Bond yields were able to regain a few points this week, particularly on Tuesday and Wednesday. The yield on U.S. government 10-year bonds was back above 2% on Thursday. We are again seeing **upward pressure on commodity prices**, which will increase the likelihood of higher and longer-lasting inflation. This will provide a significant incentive for central banks to continue their monetary tightening. Inflation could also drag down economic growth, which will have to be watched closely.
- The **European Central Bank** (ECB) has announced it will stop its asset purchases in the third quarter, which is earlier than initially indicated. It is also leaving the door open to a first interest rate hike before the end of 2022. The ECB has raised its inflation forecast and notes that the war in Ukraine adds an additional risk of upward pressure on prices in the short term.

What to Watch For

By Francis Généreux, Senior Economist, and Benoit P. Durocher, Senior Economist

UNITED STATES

WEDNESDAY March 16 - 8:30

February	**m/m**
Consensus	0.4%
Desjardins	0.2%
January	**3.8%**

Retail sales (February) – Retail sales posted a sharp increase of 3.8% in January, a significant rebound following the 2.5% drop in December. Another, much smaller gain is expected for February. On the one hand, new car sales plunged 6.4% in February, and this sector is expected to make a negative contribution to the monthly variation in total sales. On the other hand, gas prices shot up in February (even before the escalation due to the war in Ukraine). Excluding motor vehicles and gasoline, the sales trend seems fairly mixed between sectors. It is worth remembering that some household confidence indexes point to a situation where consumption may be low. However, 36,900 retail jobs were created in February, a good result, although still below the 69,200 hires in January. The waning COVID-19 wave due to the Omicron variant should support consumption, particularly in food services. Preliminary card transaction data show robust growth in nonstore retailers, but a decrease in many other categories. Overall, total retail sales could rise 0.2%, while sales excluding motor vehicles and service stations are expected to advance 0.4%.

WEDNESDAY March 16 - 14:00

March	
Consensus	0.50%
Desjardins	0.50%
January 26	**0.25%**

Federal Reserve meeting (March) – After two years of key rates at their lower bounds, the Federal Reserve (Fed) should initiate the normalization of its monetary policy at this meeting. The signals in that respect are quite clear, whether from Jerome Powell's comments after the January meeting and in the weeks that followed or from the rhetoric and interventions of other monetary policy committee members. The surging inflation and the strength of the U.S. job market are factors that support a key rate hike. The federal funds target range is expected to be raised by 25 basis points, with a 50-point movement quite possible. The only grain of sand in the gears is the war in Ukraine and its potential economic effects. It will be interesting to see whether the Fed will address it in this press release and in Jerome Powell's speech.

THURSDAY March 17 - 8:30

February	**ann. rate**
Consensus	1,700,000
Desjardins	1,760,000
January	**1,638,000**

Housing starts (February) – Housing starts fell 4.1% in January, likely a combined effect of bad weather, lower hours worked due to the Omicron variant and supply issues. However, an increase in housing starts is expected for February. While supply issues persist, the weather has improved over the past month and cases of COVID-19 have dropped. February saw 60,000 new jobs in construction. We expect housing starts to hit 1,760,000 units.

THURSDAY March 17 - 9:15

February	**m/m**
Consensus	0.5%
Desjardins	1.1%
January	**1.4%**

Industrial production (March) – Industrial production was up 1.4% in January. However, this stronger monthly growth since March 2021 is mainly the result of the record 9.9% jump in energy production, itself due to the cold temperatures. Energy production is expected to pull back in February. Growth in industrial production should nevertheless remain fairly robust, this time owing to better performance in manufacturing after a gain of just 0.2% in January. This is what the increase in hours worked in manufacturing is signalling, despite a decline in the auto sector. The mining sector should also perform well in February. All in all, we expect a 1.1% increase in industrial production and a 1.5% gain in manufacturing.

FRIDAY March 18 - 10:00

February	**m/m**
Consensus	0.3%
Desjardins	0.4%
January	**-0.3%**

Leading indicator (February) – For the first time since the pandemic low in April 2020, the leading indicator retreated in January. However, a return to growth is expected in February. Of the index's ten components, a wider interest rate spread, higher hours worked, lower jobless claims and a stronger manufacturing ISM should be the main positive contributors. The leading indicator is expected to rise 0.4% in February.

FRIDAY March 18 - 10:00	
February	**ann. rate**
Consensus	6,140,000
Desjardins	5,850,000
January	**6,500,000**

Sales of existing homes (February) – Home resales posted solid growth of 6.7% in January, whereas the consensus expected a decline. This is likely just a postponement because many signals still suggest lower sales. Pending sales fell 10.5 % in the last three months. A pullback is therefore possible. In addition, some regional data also point to a retreat. We expect existing home sales to reach 5,850,000 units.

CANADA

TUESDAY March 15 - 8:15	
February	**ann. rate**
Consensus	240,000
Desjardins	228,000
January	**230,754**

Housing starts (February) – The downtrend in housing starts should continue in February with a slight dip during the month. The especially cold temperatures in many parts of the country in February may have slowed some activities. What remains to be seen now is the extent to which interest rate hike expectations prompted some households to move up their purchase.

TUESDAY March 15 - 8:30	
January	**m/m**
Consensus	0.7%
Desjardins	1.3%
December	**0.7%**

Manufacturing sales (January) – According to Statistics Canada's interim figures, manufacturing sales were up 1.3% in January. In particular, a spike was noted in coal and petroleum product industries and in wood products. The sharp price increases in forest products and oil clearly helped drive up the value of sales for these products.

WEDNESDAY March 16 - 8:30	
February	**m/m**
Consensus	0.9%
Desjardins	1.0%
January	**0.9%**

Consumer price index (February) – Average prices at the pumps climbed 6.5% in February, which is expected to contribute about +0.2% to the monthly variation in the total consumer price index (CPI). Seasonal price fluctuations are usually around +0.4% in February, mainly due to higher prices for clothing this time of year. As in recent months, contributions from other components will remain fairly high due to imbalances in supply and demand. Ultimately, we expect a monthly variation of about +1.0% in February. Total annual inflation could therefore climb from 5.1% to 5.7%.

WEDNESDAY March 16 - 8:30	
January	**m/m**
Consensus	3.5%
Desjardins	3.9%
December	**0.6%**

Wholesale sales (January) – According to Statistics Canada's interim figures, wholesale sales were up 3.9% in January. With the exception of motor vehicles and auto parts as well as miscellaneous products, all other sectors saw higher sales during the month. The strong growth in the price of many goods is obviously helping to boost wholesale sales.

FRIDAY March 18 - 8:30	
January	**m/m**
Consensus	2.4%
Desjardins	2.4%
December	**-1.8%**

Retail sales (January) – According to Statistics Canada's interim figures, retail sales were up 2.4% in January. Preliminary results show motor vehicle sales slightly up for the month. In addition, goods prices increased 0.9% in January after seasonal adjustments, which will boost the value of sales. Gasoline in particular posted a 4.0% increase.

OVERSEAS

THURSDAY March 17 - 8:00	
March	
Consensus	0.75%
Desjardins	0.75%
February 3	**0.50%**

United Kingdom: Bank of England meeting (March) – Despite uncertainty surrounding the war in Ukraine, the Bank of England might go ahead with a third consecutive interest rate hike. At the monetary policy meeting in February, many monetary policy committee members were in favour of an increase of 50 basis points, a rather rare situation. This is an indication of the strong desire to reduce inflation.

Economic Indicators

Week of March 14 to 18, 2022

UNITED STATES

Day	Hour	Indicator	Period	Consensus		Previous data
MONDAY 14	---	---				
TUESDAY 15	8:30	Producer price index				
		Total (m/m)	Feb.	0.9%	1.0%	1.0%
		Excluding food and energy (m/m)	Feb.	0.6%	0.7%	0.8%
	8:30	Empire manufacturing index	March	7.8	9.0	3.1
	16:00	Net foreign security purchases (US$B)	Jan.	n/a	n/a	114.5
WEDNESDAY 16	8:30	Export prices (m/m)	Feb.	1.4%	1.2%	2.9%
	8:30	Import prices (m/m)	Feb.	1.5%	1.4%	2.0%
	8:30	Retail sales				
		Total (m/m)	Feb.	0.4%	0.2%	3.8%
		Excluding automobiles (m/m)	Feb.	0.8%	0.8%	3.3%
	10:00	NAHB housing market index	March	81	n/a	82
	10:00	Business inventories (m/m)	Jan.	1.1%	1.1%	2.1%
	14:00	Federal Reserve meeting	March	0.50%	0.50%	0.25%
	14:30	Speech of the Federal Reserve Chair, J. Powell				
THURSDAY 17	8:30	Initial unemployment claims	March 7-11	218,000	224,000	227,000
	8:30	Philadelphia Fed index	March	15.0	13.0	16.0
	8:30	Housing starts (ann. rate)	Feb.	1,700,000	1,760,000	1,638,000
	8:30	Building permits (ann. rate)	Feb.	1,857,000	1,845,000	1,895,000
	9:15	Industrial production (m/m)	Feb.	0.5%	1.1%	1.4%
	9:15	Production capacity utilization rates	Feb.	77.8%	78.4%	77.6%
FRIDAY 18	10:00	Leading indicator (m/m)	Feb.	0.3%	0.4%	-0.3%
	10:00	Existing home sales (ann. rate)	Feb.	6,140,000	5,850,000	6,500,000

CANADA

Day	Hour	Indicator	Period	Consensus		Previous data
MONDAY 14	---	---				
TUESDAY 15	8:15	Housing starts (ann. rate)	Feb.	240,000	228,000	230,754
	8:30	Manufacturing sales (m/m)	Jan.	0.7%	1.3%	0.7%
	9:00	Existing home sales	Feb.			
WEDNESDAY 16	8:30	Consumer price index				
		Total (m/m)	Feb.	0.9%	1.0%	0.9%
		Excluding food and energy (m/m)	Feb.	n/a	0.7%	0.6%
		Total (y/y)	Feb.	5.5%	5.7%	5.1%
		Excluding food and energy (y/y)	Feb.	n/a	4.0%	3.5%
	8:30	Wholesale sales (m/m)	Jan.	3.5%	3.9%	0.6%
	8:30	Wholesale inventories (m/m)	Jan.	n/a	2.0%	2.9%
THURSDAY 17	---	---				
FRIDAY 18	8:30	International transactions in securities ($B)	Jan.	n/a	34.58	37.56
	8:30	Retail sales				
		Total (m/m)	Jan.	2.4%	2.4%	-1.8%
		Excluding automobiles (m/m)	Jan.	2.2%	2.5%	-2.5%

Note: Desjardins, Economic Studies are involved every week in the Bloomberg survey for Canada and the United States. Approximately 15 economists are consulted for the Canadian survey and a hundred or so for the United States. The abbreviations m/m, q/q and y/y correspond to monthly, quarterly and yearly variation respectively. Following the quarter, the abbreviations f, s and t correspond to first estimate, second estimate and third estimate respectively. The times shown are Eastern Standard Time (GMT - 4 hours). Forecast of Desjardins, Economic Studies of the Desjardins Group.

Economic Indicators

Week of March 14 to 18, 2022

Country	Hour	Indicator	Period	Consensus m/m (q/q)	Consensus y/y	Previous data m/m (q/q)	Previous data y/y
OVERSEAS							
MONDAY 14							
France	3:45	Trade balance (€M)	Jan.	-9,672		-11,321	
France	3:45	Current account (€B)	Jan.	n/a		-7.1	
China	22:00	Industrial production	Feb.		4.0%		9.6%
China	22:00	Retail sales	Feb.		3.0%		12.5%
TUESDAY 15							
Germany	---	Current account (€B)	Jan.	n/a		23.9	
United Kingdom	3:00	ILO unemployment rate	Jan.	4.0%		4.1%	
France	3:45	Consumer price index – final	Feb.	0.7%	3.6%	0.7%	3.6%
Euro zone	6:00	Industrial production	Jan.	0.1%	-0.5%	1.2%	1.6%
Germany	6:00	ZEW survey – Current situation	March	-23.0		-8.1	
Germany	6:00	ZEW survey – Expectations	March	5.0		54.3	
Japan	19:50	Trade balance (¥B)	Feb.	-390.5		-932.6	
WEDNESDAY 16							
Japan	0:30	Industrial production – final	Jan.	n/a	n/a	-1.3%	-0.9%
Brazil	17:30	Bank of Brazil meeting	March	11.75%		10.75%	
THURSDAY 17							
Japan	---	Bank of Japan meeting	March	-0.10%		-0.10%	
Euro zone	6:00	Consumer price index – final	Feb.	0.9%	5.8%	0.9%	5.1%
United Kingdom	8:00	Bank of England meeting	March	0.75%		0.50%	
Japan	19:30	Consumer price index	Feb.		0.9%		0.5%
FRIDAY 18							
Japan	0:30	Tertiary industry activity index	Jan.	-1.0%		0.4%	
France	3:45	Wages – final	Q4	0.5%		0.5%	
Italy	5:00	Trade balance (€M)	Jan.	n/a		1,103	
Euro zone	6:00	Trade balance (€B)	Jan.	-9.0		-9.7	
Russia	6:30	Bank of Russia meeting	March	20.00%		20.00%	

NOTE: In contrast to the situation in Canada and the United States, disclosure of overseas economic fi gures is much more approximate. The day of publication is therefore shown for information purposes only. The abbreviations m/m, q/q and y/y correspond to monthly, quarterly and yearly variation respectively. The times shown are Eastern Standard Time (GMT - 4 hours).