WEEKLY COMMENTARY

Inflation: We Wish We Had Better News

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

As we observed in our comment last week, inflationary pressures are prompting a variety of responses from governments. This week in the US, the Biden administration announced it would release 180 million barrels of oil from the Strategic Petroleum Reserve (SPR). It will be the largest release in history, depleting nearly a third of the reserve. Despite this important news, little relief was seen in oil prices.

The intent is to mitigate energy price inflation caused by the war in Ukraine, though there's only so much the US can do alone. Oil prices are higher as a result of the war and its impact on Russian supply, but also because of supply challenges that pre-date the invasion. Last fall, OPEC+ countries agreed to increase monthly production by 0.4 million barrels per day (mbpd) but they haven't been able to actually do so. The effects of chronic underinvestment are increasingly visible. This week, OPEC+ rebuffed pressure from the US to produce more and agreed to only a modest uptick of 0.43 mbpd starting in May.

The SPR release could help prevent another escalation in oil prices. But the fact that Washington is mulling lifting sanctions on a foe like Venezuela in exchange for oil suggests the Biden administration is looking for more tangible relief. This is in a context where high inflation has depressed consumer sentiment, and mid-term elections are a mere seven months away.

We expect the Federal Reserve to intervene forcefully with a 50 basis point rate hike at its May 4 meeting and the beginning of quantitative tightening at one of its next two meetings. But it will take considerable time for these moves to curb demand, and in turn, inflation. After all, monetary policy will still be quite accommodative for most of the year. Rate hikes may be fast but monetary policy is starting from very loose settings, which were put in place to address the pandemic.

And the pandemic continues to stoke inflation as we speak. This week, China's manufacturing and non-manufacturing purchasing managers' indices both showed supplier delivery times lengthening to levels not seen since the spring of 2020. This is the direct result of the Omicron wave and China's ongoing use of sweeping lockdowns to deal with outbreaks. That means we probably won't see much relief this year when it comes to the price of many imported goods. Worse still, the price of items in short supply could climb even higher.

The pandemic is rearing its ugly head at home as well. Cases and hospitalizations are up again across Canada, which could trigger a new round of employee absenteeism and consumer caution. While public health authorities seem little inclined to reintroduce severe restrictions, pressure on hospitals will most likely be the deciding factor. Some expect the Bank of Canada (BoC) to raise rates 50 basis points on April 13. If things get grim on the pandemic front, it may be odd timing for a supersized rate hike. But the fact is also that the Canadian economy is increasingly resilient to these waves, whereas the supply disruptions caused by pandemic waves tend to add to inflationary pressures. Therefore, a hike of 50 basis points cannot be ruled out. A week ago, Deputy Governor Sharon Kozicki argued that consumers were better able to stomach monetary policy tightening. If that assertion is borne out by the results of the BoC's consumer survey next Monday, it may signal that we have to look for bold action on the 13th.

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Week in Review

By Randall Bartlett, Senior Director of Canadian Economics, Francis Généreux, Senior Economist, Lorenzo Tessier-Moreau, Senior Economist, and Hendrix Vachon, Senior Economist

- **Optimism on the financial markets has tempered this week.** Despite the announcement of a partial retreat by Russian troops, hopes of an agreement between Ukraine and Russia quickly faded. Oil prices nevertheless declined, especially after the announcement that the American government would tap in its strategic reserves. Long-term bond yields also decreased more than their short-term counterpart to the point where an inversion of the bond yield slope was observed in the United States between the 10-year and 2-year yields. That movement was amplified Friday morning when the 2- and 5-year yields where pulled higher by good employment figures in the US. In the past, these types of movements in bond yields were often precursor of a period of weak economic growth, or even a contraction.

- **Canadian real GDP by industry rose 0.2% in January**, in line with the consensus and Statistics Canada's flash estimate. However, only 9 of 20 sectors posted gains in the month. Goods-producing sectors staged a major advance (+0.8%), with construction leading the charge and utilities not far behind. Meanwhile, services-producing sectors were flat on the month (0.0%), as customer-facing sectors bore the brunt of pandemic-related mobility restrictions. With year-over-year growth of 3.5%, monthly real GDP was 0.4% above its February 2020 pre-pandemic peak in January. Real GDP growth is expected to have accelerated in February, with Statistics Canada's advanced estimate coming in at a solid 0.8% over January.

- In the United States, the March jobs report was largely in line with our forecast with 431,000 new jobs. But the upward revisions for January (+23,000) and February (+72,000) point to an even stronger labour market. The unemployment rate declined again, from 3.8% in February to 3.6% in March—a pandemic low and just shy of the previous low of 3.5%. **The strength of the US labour market could help the economy withstand higher prices and interest rates.**

- Against all expectations, according to the Conference Board index, **U.S. consumer confidence improved in March**, increasing from 105.7 (revised from 110.5) in February to 107.2 in March. The expectations component decreased again, however, from 80.8 (revised from 87.5) in February to 76.6 in March, the lowest it has been since 2014. These lower expectations and the fairly significant revision of February data nevertheless suggest that consumption may be weak in the first and second quarters, even though the labour market seems to be providing a support for household sentiment.

- **The ISM manufacturing index fell from 58.6 in February to 57.1 in March.** This is the lowest level since September 2020. Six of the ten components are down, notably new orders (-7.9 points). The decline in this component as well as in the headline index suggests that investment in equipment within real GDP could be less lively than expected.

- **Existing home prices in the United States accelerated further in January**, according to the S&P/Case-Shiller index. The monthly variation was 1.8%, reaching the cyclical peak of May 2021. The annual variation rose from 18.6% to 19.1%. Prices on the resale market continue to be buoyed by limited supply. However, the interest rate hikes should slow demand, which is expected to limit future price increases.

- **Real consumption fell 0.4% in February in the United States.** The decrease is sharper than expected, but the effect on growth forecasts for the first quarter is mitigated by an upward revision of the January increase (from 1.5% to 2.1%). Another decrease is also observed in real disposable income. The 0.2% decline is the sixth monthly drop in a row. These slumps in real income and consumption are due in part to higher prices (consumption and income increased in current dollars). The consumer expenditure deflator climbed 0.6% in February as expected. Its annual variation is now 6.4%, the highest since January 1982.

- **Inflation accelerated significantly in the euro zone in March.** The annual change in the Harmonized Consumer Price Index went from 5.9% (already the highest since data began to be published in 1991) to 7.5%. Energy plays a big role in this growth with an annual variation of 44.7%. Excluding energy and food, the core inflation rate went from 2.7% to 3.0%.

What to Watch For

By Royce Mendes, Managing Director and Head of Macro Strategy,
Randall Bartlett, Senior Director of Canadian Economics, and Francis Généreux, Senior Economist

UNITED STATES

TUESDAY April 5 - 10:00

March	
Consensus	58.5
Desjardins	56.8
February	**56.5**

ISM services index (March) – The ISM services index continued to drop in February. That makes three declines in row, for a total of 11.9 points. It suggests that the services sector is more stable now, after rebounding in response to all the different COVID-19 waves. A slight increase is expected for March, however, as signalled by the non-manufacturing regional indicators released to date for March. The ISM services index could edge up to 56.8, which is still much lower than the all-time peak of 68.4 it reached last November. However, contradictory figures from the various consumer confidence indexes point to an ongoing risk of decline.

THURSDAY April 7 - 15:00

February	US$B
Consensus	16.250
Desjardins	33.000
January	**6.838**

Consumer credit (February) – Consumer credit turned out to be much weaker than expected in January, including a net decrease in revolving loans (credit cards and credit margins). Paradoxically, that weakness coincided with January's surge in retail sales, but we expect a rebound in February, The spike in gas sales and rising food services sales seem to have boosted credit. That is also the message we are getting from the weekly data on banking credit.

CANADA

MONDAY April 4 - 10:30

Bank of Canada Business Outlook Survey & Canadian Survey of Consumer Expectations (Q1) – The Bank of Canada (BoC) will release the results of its Q1 business and consumer surveys on Monday. Both surveys are widely expected to show sentiment improving as the Omicron wave faded. That said, all eyes will be on just how high inflation expectations moved during the period. With new supply chain disruptions, a surge in global commodity prices and an even tighter labour market, a further increase in inflation expectations could be enough to see the BoC adopt a more aggressive rate hike path than we currently envision.

TUESDAY April 5 - 8:30

February	$B
Consensus	2.94
Desjardins	2.80
January	**2.62**

International merchandise trade (February) – Things continue to look up for Canadian trade in February, with both exports and imports poised to advance and the trade surplus expected to move further into the black. Commodities continue to dominate the export story, with the war in Ukraine having accelerated a rally that was already well entrenched. This was further supported by US consumers and producers, who showed little sign of slowing down in February, benefitting from the rally in the US dollar on the back of geopolitical tensions. Meanwhile, the anticipated sharp rebound in the Canadian economy in February from the post-Omicron reopening and healthy auto sales should keep imports elevated north of the border. The wildcard for the month will be the impact of the blockades at the Ambassador Bridge and other border crossings, though we suspect this may prove a wash in terms of the overall trade balance.

FRIDAY April 8 - 8:30

March	
Consensus	65,000
Desjardins	80,000
February	**336,600**

Labour Force Survey (March) – It's been typical during the pandemic that, after a wave of COVID-19, there are some immediate fireworks as companies rush to rehire. That's typically been followed by an after-party where job creation remains strong for a second consecutive month. In the latest example, the fireworks showed up in the form of 337,000 jobs in February as the Omicron wave waned, and we expect the after-party in March to reveal that employers hired another 80,000 workers. Assuming that there was also a commensurate increase in labour force participation, the unemployment rate would only fall by one tick. Still, at 5.4%, it would match the lowest reading since 1975. Wages will be in focus as policymakers try to determine how much the tight labour market is translating in new inflationary pressures.

Economic Indicators

Week of April 4 to 8, 2022

Day	Hour	Indicator	Period	Consensus	Desjardins forecast	Previous data
UNITED STATES						
MONDAY 4						
	10:00	Factory orders (m/m)	Feb.	-0.6%	-0.5%	1.4%
TUESDAY 5						
	8:30	Trade balance – Goods and services (US$B)	Feb.	-88.5	-89.0	-89.7
	10:00	ISM services index	March	58.5	56.8	56.5
	10:05	Speech of a Federal Reserve Governor, L. Brainard				
	14:00	Speech of the Federal Reserve Bank of New York President, J. Williams				
WEDNESDAY 6						
	9:30	Speech of the Federal Reserve Bank of Philadelphia President, P. Harker				
	14:00	Minutes of the Federal Reserve meeting				
THURSDAY 7						
	8:30	Initial unemployment claims	March 28-Apr. 1	200,000	197,000	202,000
	9:00	Speech of the Federal Reserve Bank of St. Louis President, J. Bullard				
	14:00	Speech of the Federal Reserve Bank of Atlanta President, R. Bostic				
	14:00	Speech of the Federal Reserve Bank of Chicago President, C. Evans				
	15:00	Consumer credit (US$B)	Feb.	16.250	33.000	6.838
	16:05	Speech of the Federal Reserve Bank of New York President, J. Williams				
FRIDAY 8						
	10:00	Wholesale inventories – final (m/m)	Feb.	2.1%	2.1%	2.1%
CANADA						
MONDAY 4						
	8:30	Building permits (m/m)	Feb.	6.8%	10.9%	-8.8%
	10:30	Release of the Bank of Canada *Business Outlook Survey*				
TUESDAY 5						
	8:30	International trade ($B)	Feb.	2.94	2.80	2.62
WEDNESDAY 6						
	10:00	PMI-Ivey index	March	n/a	n/a	60.6
THURSDAY 7						
	---	2022 Newfoundland and Labrador Budget				
	---	2022 Federal Budget				
FRIDAY 8						
	8:30	Net change in employment	March	65,000	80,000	336,600
	8:30	Unemployment rate	March	5.4%	5.4%	5.5%

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 April 4 to 8, 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 4							
Germany	2:00	Trade balance (€B)	Feb.	7.8		3.5	
Japan	20:30	PMI composite index – final	March	n/a		49.3	
Japan	20:30	PMI services index – final	March	n/a		48.7	
TUESDAY 5							
Australia	0:30	Reserve Bank of Australia meeting	April	0.10%		0.10%	
France	2:45	Industrial production	Feb.	-0.5%	2.5%	1.6%	-1.5%
Italy	3:45	PMI composite index	March	52.1		53.6	
Italy	3:45	PMI services index – final	March	51.4		52.8	
France	3:50	PMI composite index – final	March	56.2		56.2	
France	3:50	PMI services index – final	March	57.4		57.4	
Germany	3:55	PMI composite index – final	March	54.6		54.6	
Germany	3:55	PMI services index – final	March	55.0		55.0	
Euro zone	4:00	PMI composite index – final	March	54.5		54.5	
Euro zone	4:00	PMI services index – final	March	54.8		54.8	
United Kingdom	4:30	PMI composite index – final	March	59.5		59.7	
United Kingdom	4:30	PMI services index – final	March	61.0		61.0	
WEDNESDAY 6							
Germany	2:00	Factory orders	Feb.	-0.1%	6.1%	1.8%	7.3%
United Kingdom	4:30	PMI construction index	March	58.0		59.1	
Euro zone	5:00	Producer price index	Feb.	1.2%	31.7%	5.2%	30.6%
THURSDAY 7							
Japan	1:00	Leading indicator – preliminary	Feb.	100.8		102.5	
Japan	1:00	Coincident indicator – preliminary	Feb.	95.5		95.6	
Germany	2:00	Industrial production	Feb.	0.2%	3.4%	2.7%	1.8%
Euro zone	5:00	Retail sales	Feb.	0.6%	4.9%	0.2%	7.8%
Japan	19:50	Current account (¥B)	Feb.	274.8		191.7	
FRIDAY 8							
India	0:30	Reserve Bank of India meeting	April	4.00%		4.00%	
Japan	1:00	Consumer confidence	March	36.8		35.3	
Italy	4:00	Retail sales	Feb.	0.5%	n/a	-0.5%	8.4%

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).