WEEKLY COMMENTARY

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ANALYST FORECAST AWARDS
2022
#1 BEST OVERALL FORECASTER – CANADA

No Rate Hike Volck-ano for Now

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

In its outlook this week, the OECD made distinctions between the current economic environment and the stagflation episodes of the 1970s. It pointed out that economies today are less energy intensive than they were 50 years ago. Central banks have also gained independence and built their credibility through decades of successful inflation targeting. As a result, longer-term inflation expectations haven't strayed too much despite persistently high inflation of late. We think these distinctions matter. We also believe the government policy response to a recession would be entirely different today than it was back then.

Yet many refuse to put the parallels with the 1970s and 1980s to bed. In a paper released this week, Larry Summers argued that after correcting for the way US housing inflation was measured during the 1970s, inflation today isn't much lower than it was back then. His conclusion was that the same kind of tough medicine used in the early 1980s will be required to tame inflation now. When then-Fed Chair Paul Volcker famously lifted interest rates to 20%, it triggered a double-dip recession.

Central banks today don't believe that triggering a recession is necessary to regain control of inflation. However, we continue to see hawkish surprises. This week, the Reserve Bank of Australia announced a 50 basis-point hike, a move predicted by just 3 of the 29 forecasters surveyed by Bloomberg. The ECB pre-announced a 25 basis-point hike for July and opened the door to a 50 basis-point hike later. Some Governing Council members aren't opposed to a 50 basis-point hike as soon as July. With energy prices continuing to push higher and a growing sense of urgency at the ECB, we've added another hike to our 2022 forecast and now expect the refinancing rate to end the year at 1%.

Closer to home, the Bank of Canada had to nuance its messaging a bit this week. Governor Macklem is still warning about the possibility of "more forceful" action. But at the same time, the BoC's *Financial System Review* didn't hide the fact that higher interest rates will be painful for some households. Its simulations show that mortgage payments could rise by an average of 30% for borrowers who took out a five-year mortgage in 2020 or 2021. Households that stretched the most and were lured by low variable rates could be looking at a 45% jump. This would increase monthly mortgage payments by over $1,000. And that's assuming mortgage rates are around 4.5% at renewal. If Macklem were to heed Larry Summers's advice, things would get ugly pretty fast.

Thankfully, the Bank of Canada is still focused on engineering a controlled slowdown. And as we discussed in an *Economic Viewpoint* on Wednesday, a controlled slowdown is also what we envision for the housing market. We'll discuss the consequences of this housing slowdown in an analysis next week. In short, Canada's economy is more deeply tied to rates and housing than ever. As a result, we still believe this will reduce pressure on Macklem to take the overnight rate above 3%, let alone set off a Volck-ano.

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Week in Review

By Randall Bartlett, Senior Director of Canadian Economics, Tiago Figueiredo, Associate – Macro Strategy, Francis Généreux, Senior Economist, and Hendrix Vachon, Senior Economist

- Bond yields continued to rise this week. **In Canada, the 10-year bond yield reached 3.30%, its highest level since the spring of 2011.** Expectations for more aggressive monetary tightening to fight inflation have been driving these movements. They've also been fuelling fears about global economic growth and dragging down stock markets.

- **The European Central Bank took a much more hawkish tone** on Thursday, prompting us to update our eurozone rate hike forecast. We now expect the refinancing rate to end the year at 1.00%, which would imply four 25 basis-point hikes. European bond yields continued to rise on the news. Credit spreads between eurozone countries also widened. This could become a new headwind over the coming months that may hamper the euro's recovery.

- **The Canadian job market remains too hot to handle.** Full-time employment jumped 135.4K, even stronger than February's post-Omicron rebound. The services sector added 81K jobs, and the report would have been even stronger were it not for the goods sectors. Manufacturing shed 43K jobs in May and clocked one of the largest decreases since the onset of the pandemic. The unemployment rate hit a new record low of 5.1%, and there was a notable increase in year-over-year wage growth, rising 4.5% from 3.4% in April. Ultimately, the Canadian labour market remains strong—too strong—and represents a key challenge for the Bank of Canada when it comes to achieving a soft landing. The longer labour supply and demand remain unbalanced, the more nominal wage pressures are likely to intensify. While this is positive for workers who've seen real wages eroded by decades-high inflation, companies are feeling the pressure to boost consumer prices even further.

- **Following two months of strong increases, Canadian merchandise trade slowed in April, with imports rising 1.9% m/m and exports increasing 0.6%.** As a result of the faster pace of imports, Canada's merchandise trade surplus narrowed from $2.3 billion in March to $1.5 billion in April, in line with our call. Imports of consumer goods (5.5%) contributed the most to the April increase in imports, while exports of consumer goods (5.0%) rose the most of any export category in the month. Despite the rise in value, imports were down 0.4% in April in real or volume terms, while exports fell 2.1%. The advances in nominal terms were therefore the result of higher prices.

- **The US consumer price index (CPI) increased 1.0% in May after edging up 0.3% in April.** Energy prices rose 3.9%, slightly more than expected, after falling 2.7% in April. Prices for gasoline (+4.1%), fuel oil (+16.9%) and natural gas (+8.0%) were all up sharply. Food prices increased 1.2%. Core CPI, which strips out food and energy, was up 0.6% in May, matching April's advance. After slowing from 8.5% in March to 8.2% in April, **the all items index accelerated again, hitting 8.6% for the 12 months ending in May—the fastest pace since December 1981.**

- **US consumer confidence deteriorated sharply in June according to the preliminary version of the University of Michigan index.** The indicator fell from 58.4 to just 50.2, the lowest level since the index was created in the 1950s.

- **The US trade deficit narrowed in April** from a record low US$109.8B to US$88.6B, the smallest monthly deficit this year. Exports of goods and services increased 3.5% in nominal terms, while imports dropped 3.4%, likely due to the COVID lockdowns in China. Net exports are on track to make a positive contribution to second quarter real GDP.

What to Watch For

By Randall Bartlett, Senior Director of Canadian Economics,
Tiago Figueiredo, Associate – Macro Strategy, and Francis Généreux, Senior Economist

UNITED STATES

WEDNESDAY June 15 - 8:30

May	**m/m**
Consensus	0.2%
Desjardins	-0.3%
April	**0.9%**

Retail sales (May) – Retail sales growth was fairly solid in April, underpinned by gains in automotive and food services. Based on new car sales data released earlier this month, we expect sales at motor vehicle dealers to contract in May. However, we're anticipating a surge in gas station receipts, as pump prices spiked more than 9.4%. Excluding vehicles and gasoline, we expect retail sales to fall 0.4%, reflecting the impact on household budgets of higher energy prices and interest rates and low confidence. Preliminary data from card transactions also points to a decline in sales. All in all, retail sales are projected to fall 0.3%.

WEDNESDAY June 15 - 14:00

June	
Consensus	1.50%
Desjardins	1.50%
May 4	**1.00%**

Federal Reserve meeting (June) – The Federal Reserve (Fed) clearly indicated that interest rate hikes would continue at the same pace for several more meetings. As such, it's fairly certain that the Fed will opt for another 50 basis-point increase like it did at its May 4 meeting. The Fed will also publish its latest projections on economic growth, inflation and a path for the federal funds rate over the next few years. This should give us more insight into how high the Fed intends to raise rates.

THURSDAY June 16 - 8:30

May	**ann. rate**
Consensus	1,707,000
Desjardins	1,730,000
April	**1,724,000**

Housing starts (May) – Housing starts were down 0.2% in April after a bigger 2.8% dip in March and a solid 6.6% gain in February. Housing starts are still fairly high at 1,724,000. However, based on the recent plunge in sales of new single-family homes, April's 3.0% drop in building permits and the decline in mortgage applications for home purchases—all of which are due to higher interest rates—we believe this figure will fall eventually. For now, continued employment growth in the residential construction sector is tempering the impact on housing starts. All told, we expect housing starts to hit 1,730,000 units in May.

FRIDAY June 17 - 9:15

May	**m/m**
Consensus	0.4%
Desjardins	0.1%
April	**1.1%**

Industrial production (June) – In April, industrial production posted its biggest monthly gain since October, largely thanks to jumps in energy production and the automotive sector. However, we expect these two sectors to fall back somewhat in May and drag down the monthly figure. In the energy sector, slightly above-average temperatures didn't hasten the switch from heating to air conditioning. Meanwhile, May's 3.3% drop in hours worked in the automotive sector isn't a good sign. We anticipate that the rest of the manufacturing sector will grow 0.2%, while the sector as a whole is likely to stagnate. Overall, we expect industrial production to rise just 0.1%.

FRIDAY June 17 - 10:00

May	**m/m**
Consensus	-0.4%
Desjardins	-0.3%
April	**-0.3%**

Leading indicator (May) – The leading indicator dropped 0.3% in April, its second monthly contraction this year after January's 0.6% dip. We're forecasting a further 0.3% decline in May, with the stock market and household confidence providing the main headwinds this time.

CANADA

TUESDAY June 14 - 8:30	
April	**m/m**
Consensus	2.0%
Desjardins	1.3%
March	**2.5%**

Manufacturing sales (April) – Manufacturing activity is expected to have slowed to a more typical pace in April, advancing by 1.3% m/m after surging ahead 2.5% in March. The April gain will likely be a price story, as the Canadian dollar depreciated, oil prices rose, and the general price level of goods advanced further in the month, all contributing to higher manufacturing prices. At the same time, volumes likely moved ahead slightly on higher manufacturing employment and motor vehicle production in April, although lower import volumes of key manufacturing inputs may have weighed on activity. Notably, our forecast for April is below Statistics Canada's flash estimate of 1.6%.

WEDNESDAY June 15 - 8:15	
May	**ann. rate**
Consensus	242,500
Desjardins	255,000
April	**267,300**

Housing starts (May) – After surprising economists by surging in April, housing starts are expected to fall back in May to levels closer to those seen in the first quarter of 2022. Building permits are part of the story. The number of building permits issued for new units was flat, albeit still elevated, for the better part of a year before surging in April. At the same time, existing home sales have fallen consistently since February, and this may be starting to weigh on home building activity.

WEDNESDAY June 15 - 9:00	
May	
Consensus	n/a
Desjardins	-5.9%
April	**-12.6%**

Existing home sales (May) – With April's 12.6% m/m drop in existing home sales fresh in homeowners' minds, May's 5.9% anticipated decline should come as some relief. April saw the biggest monthly contraction since the start of the pandemic back in early 2020. The headline decline in May will likely reflect a downshift in activity across the country, from Vancouver in the west to Ottawa in the east and almost everywhere in between. But while a further move lower in May could be an indication that the correction will continue, it doesn't mean there will be a collapse, as we argued in a recent *Economic Viewpoint*.

THURSDAY June 16 - 8:30	
April	**m/m**
Consensus	0.4%
Desjardins	0.0%
March	**0.3%**

Wholesale trade (April) – Wholesale trade is expected to be broadly flat in April. An increase in employment in the sector should be roughly offset by weakness in some key import categories, weighing on wholesale volumes. Meanwhile prices likely advanced again in April, but at a more tepid pace than in the previous month. Our forecast is slightly below Statistics Canada's 0.2% flash estimate.

FRIDAY June 17 - 8:30	
May	**m/m**
Consensus	n/a
Desjardins	0.2%
April	**0.8%**

Industrial product price index (May) – Despite energy prices moving meaningfully higher in May, the decline in non-energy commodity prices is expected to have kept the advance in the industrial production price index to a modest 0.2%. The weaker Canadian dollar also helped keep it in positive territory, as did persistent yet gradually diminishing global supply chain disruptions.

FRIDAY June 17 - 8:30	
May	**m/m**
Consensus	n/a
Desjardins	0.8%
April	**-2.0%**

Raw materials price index (May) – The raw materials price index likely moved higher in May on the back of resurgent energy prices, shaking off the price weakness in non-energy commodities such as metals and minerals as well as forestry products.

OVERSEAS

MONDAY June 13 - 2:00	
April	**m/m**
Consensus	0.1%
March	**-0.1%**

United Kingdom: Monthly GDP (April) – After stagnating in February, UK GDP slipped back 0.1% in March, resulting in non-annualized first quarter real GDP growth of 0.8%. April's monthly data will provide some initial insight into the second quarter. The war in Ukraine and subsequent spike in energy prices have likely caused the UK economy more problems. However, after declining 1.2% in March, retail sales increased 1.4%, which may be a sign of a rebound.

TUESDAY June 14 - 22:00

May	**y/y**
Consensus	-7.1%
April	**-11.1%**

China: Retail sales (May) – Lockdowns in China's major cities lasted almost the entire month of May before being lifted on June 1. As such, we shouldn't expect much of a rebound in retail sales or production in last month's figures. However, improving PMI indexes and exports growth indicate that the worst is probably already behind us, and we don't think Chinese indicators will deteriorate further. We're forecasting another round of negative annual variations similar to those of April, and we'll likely have to wait for June's numbers to see any net gains.

THURSDAY June 16 - 7:00

June	
Consensus	1.25%
Desjardins	1.25%
May 5	**1.00%**

United Kingdom: Bank of England meeting (June) – With inflation topping 9%, now isn't the time for the Bank of England (BoE) to consider slowing interest rate hikes. We're therefore expecting another 25 basis-point increase. However, the risks to economic growth are of greater concern. It'll be more difficult for the BoE to achieve a soft landing, so it may eventually start signalling more gradual rate hikes.

Economic Indicators

Week of June 13 to 17, 2022

UNITED STATES

Date	Time	Indicator	Period	Consensus	⬡	Previous data
MONDAY 13	14:00	Speech of a Federal Reserve Governor, L. Brainard				
TUESDAY 14	8:30	Producer price index				
		Total (m/m)	May	0.8%	1.2%	0.5%
		Excluding food and energy (m/m)	May	0.6%	0.8%	0.4%
WEDNESDAY 15	8:30	Empire manufacturing index	June	3.0	3.0	-11.6
	8:30	Export prices (m/m)	May	1.4%	1.0%	0.6%
	8:30	Import prices (m/m)	May	1.2%	1.0%	0.0%
	8:30	Retail sales				
		Total (m/m)	May	0.2%	-0.3%	0.9%
		Excluding automobiles (m/m)	May	0.7%	0.3%	0.6%
	10:00	NAHB housing market index	June	68	n/a	69
	10:00	Business inventories (m/m)	April	1.2%	1.2%	2.0%
	14:00	Federal Reserve meeting	June	1.50%	1.50%	1.00%
	14:30	Speech of the Federal Reserve Chair, J. Powell				
	16:00	Net foreign security purchases (US$B)	April	n/a	n/a	23.1
THURSDAY 16	8:30	Initial unemployment claims	June 6-10	215,000	215,000	229,000
	8:30	Philadelphia Fed index	June	7.0	3.0	2.6
	8:30	Housing starts (ann. rate)	May	1,707,000	1,730,000	1,724,000
	8:30	Building permits (ann. rate)	May	1,790,000	1,800,000	1,823,000
FRIDAY 17	8:45	Speech of the Federal Reserve Chair, J. Powell				
	9:15	Industrial production (m/m)	May	0.4%	0.1%	1.1%
	9:15	Production capacity utilization rates	May	79.3%	79.1%	79.0%
	10:00	Leading indicator (m/m)	May	-0.4%	-0.3%	-0.3%
	16:40	Speech of a Federal Reserve Governor, C. Waller				

CANADA

Date	Time	Indicator	Period	Consensus	⬡	Previous data
MONDAY 13	8:30	National balance sheet	Q1			
TUESDAY 14	8:30	Manufacturing sales (m/m)	April	2.0%	1.3%	2.5%
WEDNESDAY 15	8:15	Housing starts (ann. rate)	May	242,500	255,000	267,300
	9:00	Existing home sales	May	n/a	-5.9%	-12.6%
THURSDAY 16	8:30	Wholesale sales (m/m)	April	0.4%	0.0%	0.3%
FRIDAY 17	8:30	Industrial product price index (m/m)	May	n/a	0.2%	0.8%
	8:30	Raw materials price index (m/m)	May	n/a	0.8%	-2.0%
	8:30	International transactions in securities ($B)	April	n/a	n/a	46.94

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 June 13 to 17, 2022

Country	Time	Indicator	Period	Consensus m/m (q/q)	Consensus y/y	Previous data m/m (q/q)	Previous data y/y
OVERSEAS							
MONDAY 13							
United Kingdom	2:00	Trade balance (£M)	April	-10,650		-11,552	
United Kingdom	2:00	Construction	April	-0.5%	3.8%	1.7%	4.7%
United Kingdom	2:00	Index of services	April	0.1%		-0.2%	
United Kingdom	2:00	Monthly GDP	April	0.1%		-0.1%	
United Kingdom	2:00	Industrial production	April	0.3%	1.7%	-0.2%	0.7%
TUESDAY 14							
Japan	0:30	Industrial production – final	April	n/a	n/a	-1.3%	-4.8%
United Kingdom	2:00	ILO unemployment rate	April	3.6%		3.7%	
Germany	2:00	Consumer price index – final	May	0.9%	7.9%	0.9%	7.9%
Germany	5:00	ZEW survey – Current situation	June	-31.0		-36.5	
Germany	5:00	ZEW survey – Expectations	June	-26.0		-34.3	
China	22:00	Industrial production	May		-1.0%		-2.9%
China	22:00	Retail sales	May		-7.1%		-11.1%
WEDNESDAY 15							
Japan	0:30	Tertiary industry activity index	April	0.8%		1.3%	
France	2:45	Consumer price index – final	May	0.6%	5.2%	0.6%	5.2%
Euro zone	5:00	Trade balance (€B)	April	-14.5		-17.6	
Euro zone	5:00	Industrial production	April	0.5%	-1.1%	-1.8%	-0.8%
Brazil	17:30	Bank of Brazil meeting	June	13.25%		12.75%	
Japan	19:50	Trade balance (¥B)	May	-1,705		-1,618	
THURSDAY 16							
Japan	---	Bank of Japan meeting	June	-0.10%		-0.10%	
Switzerland	3:30	Swiss National Bank meeting	June	-0.75%		-0.75%	
United Kingdom	7:00	Bank of England meeting	June	1.25%		1.00%	
FRIDAY 17							
United Kingdom	2:00	Retail sales	May	-0.6%	-4.3%	1.4%	-4.9%
Euro zone	5:00	Construction	April	n/a	n/a	0.0%	3.3%
Euro zone	5:00	Consumer price index – final	May	0.8%	8.1%	0.8%	7.4%
Italy	5:00	Trade balance (€M)	April	n/a		-84	

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).