WEEKLY COMMENTARY

The Soft Landing Challenge

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

We got a bit of a surprise this week when we learned US GDP contracted by 1.4% in the first quarter. Thankfully, soaring imports were the cause, whereas domestic demand grew fairly robustly.

However, the big picture remains the same: economic growth will soften this year. In Canada, we expect the economy to cool significantly in the second half of the year. In part, this is because high prices have already started to bite. As we commented this week in our *Spotlight on Housing*, we expect home sales to keep weakening and there are signs that prices may have already peaked. This is especially the case in small metropolitan areas that have experienced outsized price increases since the beginning of the pandemic.

We're also seeing inflation biting into household purchasing power. Some of the dynamics we marvelled at during the pandemic are shifting. Take disposable income, for instance. The big story in 2020 was how disposable income managed to increase despite a contracting economy. Fast-forward to today, and inflation-adjusted disposable income has dipped below its pre-pandemic trend.

A similar pattern can be seen in inflation-adjusted cash deposits. These are still slightly above their pre-pandemic trend, but they're quickly converging to it. Higher mortgage rates are eating up more of the income available for discretionary spending, particularly for those with variable rate mortgages or fixed mortgages up for renewal soon. And the wealth effect is not supportive, as we expect a number of equity markets to deliver negative returns this year. All these factors are prompting governments to try to soften the blow. As we observed in our *Budget Analysis* this week, Ontario was the latest to roll out fiscal relief measures.

Whether these developments constitute fodder for a recession is a growing debate. There's no law of nature stating that a combination of low unemployment, high inflation and the start of a hiking cycle means a recession must be imminent. In this cycle, a lot will depend on how inflation is tamed. If it requires interest rates going well above neutral, then yes, the risk of short-circuiting the expansion will increase substantially.

But this isn't our baseline scenario at the moment. Given the forces already acting to rein in consumer spending—which is one of the first steps towards getting a handle on inflation—it still doesn't look like central bankers will need to push interest rates very far above neutral. In Canada, we believe high sensitivity to interest rates will in fact prevent the Bank of Canada (BoC) from going above its stated neutral range. If so, excess demand for workers could start to ease and consumer spending and housing activity cool, but without the mass layoffs we've seen at the beginning of previous recessions.

We saw this dynamic play out in 2019. The Canadian economy grew at a sub-2% pace, rates were kept unchanged after the 2017–2018 rate hike cycle, and the unemployment rate was fairly stable during the year. Importantly, the BoC hadn't brought rates above neutral because inflation was under control. We may see a similar outcome this time around, but that will be contingent on supply shocks finally abating. That's not what we've seen so far this year. Achieving a soft landing is a difficult, but not insurmountable, challenge.

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Desjardins, Economic Studies: 514-281-2336 or 1 866-866-7000, ext. 5552336 • desjardins.economics@desjardins.com • desjardins.com/economics

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

- **Stock markets have been very volatile this week.** Fears over global economic growth have increased recently following the more hawkish tone from central bankers, threats of escalating war in Ukraine and China's difficulty in managing rising COVID-19 cases. The worst session was recorded Tuesday, with declines of around 3% for several indexes. Weaker demand for risky assets also caused bond yields to retreat temporarily and boosted the US dollar. However, the momentum turned more favourable for the stock markets later in the week, helped by some solid corporate earnings.

- **Canadian real GDP by industry rose a consensus-beating 1.1% m/m in February**, as 16 of 20 sectors advanced. This was the ninth consecutive monthly real GDP increase. Goods-producing sectors were the real stars of the release, clocking in at a solid 1.5% as resource extraction and construction led the charge. At the same time, services-producing sectors were no slouch, advancing by 0.9% in February as the economy reopened after Omicron lockdowns. Real GDP growth is expected to have moderated in March, with Statistics Canada's advanced estimate coming in at a still respectable 0.5% over February. This would bring real GDP to roughly 2% above its pre-pandemic level at the end of the first quarter. Taken together, real GDP growth should come in around 5.5% (q/q, saar) in Q1 2022. This is meaningfully higher than the 3.0% advance published by the Bank of Canada in its April 2022 *Monetary Policy Report*.

- According to the US Commerce Department's advance estimate, **real GDP contracted at an annualized rate of 1.4% in the first quarter**. The biggest negative contributor was international trade, which took a 3.20-point bite out of real GDP. Though international trade and inventory investment (-0.84-point contribution) weighed on GDP growth, final domestic demand was up 2.6%. That measure provides a better snapshot of the health of the US economy, which continues to post big job gains and generate inflation.

- **Real consumption by US consumers was a little stronger than expected in March** with a gain of 0.2% when stagnation was expected. Real disposable income fell 0.4% and the consumer spending deflator jumped 0.9%. The slightly stronger growth in consumption leads to a greater carry-over effect for the second quarter of 2022.

- **According to the Conference Board index, US consumer confidence dipped slightly in April**, from 107.6 (revised from 107.2) to 107.3. Household sentiment about current conditions declined once again, but expectations for the future are in better shape. This is a fairly positive sign that could boost consumer spending.

- **New durable goods orders rose 0.8% in March in the United States.** The 1.0% increase in orders for non-defence capital goods excluding aircraft is also noteworthy after two successive 1.1% drops. This is reflected in the 15.3% annualized growth in real investment in equipment in the first quarter of 2022.

- Although sales are slowing, **prices of existing homes spiked in February in the United States**. The S&P/Case-Shiller index jumped 2.4%—its biggest monthly gain since the index was created in 2000. The annual variation rose from 19.1% to 20.2%. Home prices continue to be buoyed by low inventory, although interest rate hikes should ease the pressure eventually.

- **Real GDP in the eurozone increased by 0.2% (non-annualized) in the first quarter of 2022**, following a gain of 0.3% at the end of 2021. The Omicron wave of COVID-19 as well as the war in Ukraine, which affected activity in March, are among the factors that led to this relatively weak growth.

- **Inflation remained strong in the eurozone in April.** The total consumer price index rose 0.6% after jumping 2.4% in March. Total inflation is now at 7.5%. Energy prices, however, fell in April.

What to Watch For

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

UNITED STATES

MONDAY May 2 - 10:00

April	
Consensus	57.7
Desjardins	57.5
March	**57.1**

ISM manufacturing index (April) – Following a brief increase in February, the ISM manufacturing resumed its downward trend in March, hitting 57.1—its lowest level since September 2020. But based on the regional indicators released to date, we're expecting a slight uptick in April. The ISM components that provide insight into supply chain issues—especially supplier deliveries, backlog of orders, and prices—will make for interesting reading. They could tell us whether the war in Ukraine and lockdowns in China are continuing to impact US manufacturing.

TUESDAY May 3

April	**ann. rate**
Consensus	13,800,000
Desjardins	14,500,000
March	**13,330,000**

New car sales (April) – After spiking in January, new car sales declined in February (-7.0%) and March (-4.6%). We expect a turnaround in April, although annualized sales are still likely to remain below the 15,018,000 units we saw at the beginning of the year.

WEDNESDAY May 4 - 10:00

April	
Consensus	58.4
Desjardins	58.4
March	**58.3**

ISM services index (April) – The ISM services posted a surprise 1.8-point gain in March, ending three straight months of declines which saw the index fall from its recent peak of 68.4 to a still solid 58.3. The index is expected to remain relatively unchanged in April. Certain regional non-manufacturing indicators fell during the month, but consumer confidence stabilized.

WEDNESDAY May 4 - 14:00

May	
Consensus	1.00%
Desjardins	1.00%
March 16	**0.50%**

Federal Reserve meeting (May) – After keeping key rates at their lower bound for two years, the Federal Reserve (Fed) initiated rate liftoff in March with a 25-basis point hike. Given persistently high inflation and a strong labour market—and despite a drop in real GDP in the first quarter—look for the Fed to pick up the pace. We're anticipating a 50-basis point hike when the Fed wraps up its May meeting on Wednesday. Some committee members may even be in favour of a 75-basis point increase. The Fed is also expected to announce that it will begin quantitative tightening soon, likely trimming its balance sheet by US$50B per month to start.

FRIDAY May 6 - 8:30

April	
Consensus	390,000
Desjardins	375,000
March	**431,000**

Job creation according to the establishment survey (April) – Although hiring slowed in March from the previous year-to-date monthly average of 627,000, the US job market remains very robust. As such, we're expecting strong gains again in April. New jobless claims remained exceptionally low and household sentiment about the job market is still very positive. We therefore expect the economy to add 375,000 jobs in April, keeping the unemployment rate at 3.6%. Much like in March, average hourly wages should increase 0.4%, slowing annual wage growth slightly.

FRIDAY May 6 - 15:00

March	**US$B**
Consensus	24.00
Desjardins	70.00
February	**41.82**

Consumer credit (March) – Consumer credit rose sharply in February, up US$41.8B. This is the biggest monthly gain on record, except for methodologic changes. Based on weekly banking credit data, consumer credit is expected to surge even higher in March, spiking nearly US$70.0B. Soaring gas prices may be to blame.

CANADA

WEDNESDAY May 4 - 8:30	
March	**$B**
Consensus	3.90
Desjardins	4.90
February	**2.66**

International merchandise trade (March) – Canada's trade surplus in goods is expected to have increased considerably in March, as the value of exports surged on higher commodity prices, a stronger Canadian dollar, and persistent demand south of the border. Imports are also anticipated to have advanced, albeit less so as prices may have moderated in the month and demand at home was relatively more muted than it was stateside. Looking at Q1 as whole, the value of exports is expected to have posted another meaningful advance, although this can all be chalked up to price gains as export volumes likely declined in the quarter. But as import volumes probably fell by even more in Q1, it won't come as surprise if trade makes a positive overall contribution to growth in the first quarter even if each individual series underperformed to start the year.

FRIDAY May 6 - 8:30	
April	
Consensus	40,000
Desjardins	60,000
March	**72,500**

Labour Force Survey (April) – After racing ahead in February and March, the Canadian labour market doesn't look to be pulling over for a pit stop anytime soon. In March, there were still almost 200K fewer workers in the accommodation and food services industry than pre-pandemic. That, of course, is despite the unemployment rate hitting a record low during the month. Given the positive trends seen in mobility, dining reservations and hotel room prices, it's likely that restaurants, bars and hotels continued to add workers in April. The 60K new hires we're forecasting for the whole economy would push the unemployment rate down only one tick to 5.2%, assuming there was also a further rebound in labour force participation. To attract workers in an already drum-tight labour market, employers likely had to offer higher pay. As a result, expect the annual pace of wage growth to have accelerated as well.

OVERSEAS

THURSDAY May 5 - 7:00	
May	
Consensus	1.00%
Desjardins	1.00%
March 17	**0.75%**

United Kingdom: Bank of England meeting (May) – The Bank of England (BoE) is expected to announce a fourth consecutive interest rate hike, bringing the Bank Rate to 1.00%. Since the last Monetary Policy Committee meeting, inflation has continued to rise more quickly than expected. However, certain economic growth data—plus the risks generated by the war in Ukraine—are of greater concern. The BoE faces the daunting task of taming inflation while also avoiding a recession.

Economic Indicators

Week of May 2 to 6, 2022

Day	Hour	Indicator	Period	Consensus	Desjardins	Previous data
UNITED STATES						
MONDAY 2	10:00	Construction spending (m/m)	March	0.7%	0.8%	0.5%
	10:00	ISM manufacturing index	April	57.7	57.5	57.1
TUESDAY 3	---	Total vehicle sales (ann. rate)	April	13,800,000	14,500,000	13,330,000
	10:00	Factory orders (m/m)	March	1.2%	1.1%	-0.5%
WEDNESDAY 4	8:30	Trade balance – Goods and services (US$B)	March	-106.5	-107.9	-89.2
	10:00	ISM services index	April	58.4	58.4	58.3
	14:00	Federal Reserve meeting	May	1.00%	1.00%	0.50%
	14:30	Speech of the Federal Reserve Chair, J. Powell				
THURSDAY 5	8:30	Initial unemployment claims	April 25-29	180,000	180,000	180,000
	8:30	Nonfarm productivity – preliminary (ann. rate)	Q1	-3.0%	-5.5%	6.6%
	8:30	Unit labor costs – preliminary (ann. rate)	Q1	7.3%	10.6%	0.9%
FRIDAY 6	8:30	Change in nonfarm payrolls	April	390,000	375,000	431,000
	8:30	Unemployment rate	April	3.5%	3.6%	3.6%
	8:30	Weekly worked hours	April	34.7	34.7	34.6
	8:30	Average hourly earnings (m/m)	April	0.4%	0.4%	0.4%
	9:15	Speech of the Federal Reserve Bank of New York President, J. Williams				
	15:00	Consumer credit (US$B)	March	24.00	70.00	41.82
	15:00	Speech of the Federal Reserve Bank of Atlanta President, R. Bostic				
	19:15	Speech of a Federal Reserve Governor, C. Waller				
	19:15	Speech of the Federal Reserve Bank of St. Louis President, J. Bullard				
	20:00	Speech of the Federal Reserve Bank of San Francisco President, M. Daly				
CANADA						
MONDAY 2	---	---				
TUESDAY 3	12:30	Speech of the Bank of Canada Senior Deputy Governor, C. Rogers				
WEDNESDAY 4	8:30	International trade ($B)	March	3.90	4.90	2.66
THURSDAY 5	9:40	Speech of a Bank of Canada Deputy Governor, L. Schembri				
FRIDAY 6	8:30	Net change in employment	April	40,000	60,000	72,500
	8:30	Unemployment rate	April	5.2%	5.2%	5.3%

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 May 2 to 6, 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 2							
Japan	1:00	Consumer confidence	April	34.9		32.8	
Germany	2:00	Retail sales	March	0.3%	-0.5%	0.3%	7.1%
Italy	3:45	PMI manufacturing index	April	55.0		55.8	
France	3:50	PMI manufacturing index – final	April	55.4		55.4	
Germany	3:55	PMI manufacturing index – final	April	54.1		54.1	
Euro zone	4:00	PMI manufacturing index – final	April	55.3		55.3	
Italy	4:00	Unemployment rate	March	8.4%		8.5%	
United Kingdom	4:30	PMI manufacturing index – final	April	55.3		55.3	
Euro zone	5:00	Consumer confidence – final	April	n/a		-16.9	
Euro zone	5:00	Industrial confidence	April	9.5		10.4	
Euro zone	5:00	Services confidence	April	13.5		14.4	
Euro zone	5:00	Economic confidence	April	108.0		108.5	
TUESDAY 3							
Australia	0:30	Reserve Bank of Australia meeting	May	0.25%		0.10%	
Euro zone	5:00	Producer price index	March	4.9%	36.2%	1.1%	31.4%
Euro zone	5:00	Unemployment rate	March	6.8%		6.8%	
WEDNESDAY 4							
Germany	2:00	Trade balance (€B)	March	10.0		11.4	
Italy	3:45	PMI composite index	April	54.1		52.1	
Italy	3:45	PMI services index	April	54.3		52.1	
France	3:50	PMI composite index – final	April	57.5		57.5	
France	3:50	PMI services index – final	April	58.8		58.8	
Germany	3:55	PMI composite index – final	April	54.5		54.5	
Germany	3:55	PMI services index – final	April	57.9		57.9	
Euro zone	4:00	PMI composite index – final	April	55.8		55.8	
Euro zone	4:00	PMI services index – final	April	57.7		57.7	
United Kingdom	4:30	PMI composite index – final	April	57.6		57.6	
United Kingdom	4:30	PMI services index – final	April	58.3		58.3	
Euro zone	5:00	Retail sales	March	-0.1%	1.8%	0.3%	5.0%
Brazil	17:30	Bank of Brazil meeting	May	12.75%		11.75%	
THURSDAY 5							
Germany	2:00	Factory orders	March	-1.0%	-0.6%	-2.2 %	2.9%
France	2:45	Industrial production	March	-0.2%	1.4%	-0.9 %	2.4%
Norway	4:00	Bank of Norway meeting	May	0.75%		0.75%	
United Kingdom	7:00	Bank of England meeting	May	1.00%		0.75%	
Japan	19:30	Consumer price index – Tokyo	April		2.3%		1.3%
FRIDAY 6							
Germany	2:00	Industrial production	March	-1.0%	-0.4%	0.2%	3.2%
Italy	4:00	Retail sales	March	n/a	n/a	0.7%	4.3%
United Kingdom	4:30	PMI construction index	April	58.0		59.1	

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).