WEEKLY COMMENTARY

Spinting Towards Neutral

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

Yesterday, we released our *Economic & Financial Outlook*, titled *Central Banks Mount an Assault on High Inflation*. We made meaningful adjustments to our Canadian inflation and growth outlooks, lifting both forecasts for 2022 but downgrading them for 2023.

As we've been revising inflation forecasts higher in recent months and given that central banks are behind the curve, we have adjusted our views for rates two-fold. First, we believe that we are currently in a shock treatment phase, which will see more supersized hikes and the start of quantitative tightening. In fact, we currently expect the Bank of Canada (BoC) to deliver a 75 basis-point hike in June.

Second, we believe that policy rates will peak at higher levels than they did in the previous cycle. This means an overnight rate of 2.25% in Canada and a federal funds rate of 3.25% in the US next year. The implication is that we now expect the Fed to lift rates further above neutral than its median forecast has suggested.

While our projection has inflation gradually moderating, it won't be back below 3% before next year. And there are many reasons to think it might take even longer for inflation to normalize. The first is food, which accounts for 16% of the consumer spending basket. As we discussed in a recent *Weekly Commentary*, food prices are one of the main ways the war in Ukraine is affecting the rest of the world. This week's inflation report showed that Canadian grocery prices are up 8.7% year over year, the fastest pace since 2009. And it's safe to assume they'll continue to rise as the impact of developments in Ukraine makes its way through the food processing chain.

The second reason is supply chains. We hoped to start seeing them gradually improve this year. Instead we got the Ukraine war and new lockdowns in China. Meanwhile the semiconductor shortage is nowhere near being solved, and car dealer lots remain thinly stocked. Hiking rates more forcefully won't fix these issues directly, but it will address one of their root causes: strong demand.

Psychology is the third reason. Given what's driving inflation, the current policy normalization campaign is partly an exercise in persuasion. Even if long-term inflation expectations remain anchored, households and businesses could eventually lose faith in central banks' ability to curb rising prices. We expect that Canadian inflation will have overshot the BoC's target range for nearly two years. We're already seeing a change in behaviour, with companies feeling more emboldened to pass along higher costs without worrying about losing market share. That's a marked shift in mindset from the previous cycle. The longer inflation is out of control, the more this behaviour becomes entrenched.

Meanwhile, with workers being in short supply, they'll have a strong incentive to protect their purchasing power. This doesn't necessarily mean strikes. It can be things like switching to a higher-paying job, asking to work less for the same pay, or turning down a job that doesn't pay enough. Price and wage expectations ultimately guide these behaviours. That's why central banks are now in such a rush. They want to keep those expectations in check. To do that, they'll have to tighten more than they did in the last cycle. Doing so, central banks could end up shortening the expansion cycle. But they seem willing to live with that risk.

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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

- **Central bankers again signalled more aggressive interest rate hikes this week.** Bond yields continued to rise. Both the US and Canadian 10-year yield are above 2.90%. Higher-than-expected inflation in Canada helped narrow the spread between US and Canadian bond yields. Buoyed by solid corporate earnings, the stock markets started the week on a positive note, but many ended the week lower.

- **Canadian consumer prices rose 1.4% in March, leaving the annual rate at 6.7%, the fastest pace since January 1991.** Canadian food and energy prices were major drivers of the overall increase in March, a result of Russia's invasion of Ukraine. Core prices rose 0.6% in seasonally adjusted terms and are up 4.6% over the year, reflecting several factors. Supply chain issues came to a head, driving durable goods prices higher. Separately, the broader reopening of the economy allowed services businesses to pass on higher costs to consumers. It's clear that the Bank of Canada needs to continue to act "forcefully" to quell further inflationary pressures.

- **Canadian housing starts took a step back in March, clocking in at 246,000 on a seasonally adjusted basis.** This is down from 250,000 the prior month and about 300,000 at their peak in the first half of 2021. That said, national housing starts remain well above the roughly 215,000 annual average in the few years prior to the pandemic. Looking at the regional breakdown in March, Quebec and Atlantic Canada saw notable advances, though they were more than offset by declines in Ontario, British Columbia and the Prairie Provinces. Dwellings under construction were roughly flat, while housing completions picked up modestly in the month.

- **Existing home sales fell the most in March since June 2021, dropping by 5.4% to 55,000 units.** About 80% of the decline was concentrated in Ontario, and Toronto specifically, followed by Alberta. The rest of the country saw a more mixed performance. The average home price declined for the first time since July 2021, with British Columbia and Ontario leading the drop in dollar terms (about -$25,000) and Alberta seeing the largest relative decline (-3.6%). With interest rates rising, affordability eroding, and policymakers taking action to increase supply and cool investor demand, this could be the beginning of a return to more typical conditions in the Canadian housing market.

- **Canadian retail sales bucked contraction expectations in February, rising 0.1% m/m, albeit due to a 0.5% increase in prices more than offsetting a 0.4% drop in sales volumes.** This followed a 3.3% m/m advance in January. The modest advance in February retail sales was the result of gains in 6 of 11 sectors, most notably gasoline stations on higher fuel prices, building materials on a still-hot housing market, and clothing stores. In contrast, sales at motor vehicles and parts dealers took a sharp downshift in February, no doubt partly reflecting the recent run-up in prices of light vehicles and everything else. Looking ahead, Statistics Canada's flash estimate for March retail sales is a healthy 1.4%.

- **US housing starts rose 0.3% in March**, following a much larger 6.5% increase in February. This brings the annualized figure to 1,793,000 units, which is just below our forecast. The number of housing starts in the first quarter suggests that residential investment will continue be a key contributor to real GDP growth despite the lack of supply hampering the sector.

- **Sales of existing homes dropped 2.7% in March in the US**, following February's 8.4% plunge and January's 14.2% spike. We expect that recent and future mortgage rate increases will ultimately lead to a slowdown in activity in both the new construction and existing home markets.

What to Watch For

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

UNITED STATES

TUESDAY April 26 - 8:30	
March	**m/m**
Consensus	1.0%
Desjardins	1.1%
February	**-2.1%**

New durable goods orders (March) – Despite a sharp rebound in military aircraft orders, new durable goods orders saw a 5.3% drop in transportation sector orders in February. Orders excluding transportation also experienced a rare decline (-0.6%). We expect better results on both counts in March. Orders at Boeing are pointing toward a rise in civil aviation orders, while March's industrial production figures suggest that auto sector orders are growing sharply. Excluding transportation, we also expect to see a return to a positive trend despite a substantial decline in the ISM manufacturing index's "new orders" component, from 61.7 to 53.8. Overall, new orders are expected to increase 1.1%, and 0.3% excluding transportation.

TUESDAY April 26 - 9:00	
February	**y/y**
Consensus	19.20%
Desjardins	18.90%
January	**19.10%**

S&P/Case-Shiller index of existing home prices (February) – In January, the Case-Shiller index posted its biggest monthly gain since March 2013. The 1.8% increase bumped up the index's annual variation to 19.1%. We expect further sharp growth in February given that housing inventory remains very low and demand is still relatively high. We're forecasting monthly growth of 1.2%, which would bring the annual figure down slightly to 18.9%.

TUESDAY April 26 - 10:00	
April	
Consensus	108.3
Desjardins	110.0
March	**107.2**

Conference Board consumer confidence index (April) – While other consumer confidence indicators continued to slip in March, the Conference Board index was surprisingly resilient, gaining 1.5 points. The index was less affected by the war in Ukraine and soaring gas prices, and may have continued to improve in April. Signs were not particularly effective a month ago, but the drop in gas prices since mid-March may give the index another boost. Although stock market trends and concerns over inflation are still headwinds, we expect the Conference Board index to rise from 107.2 to 110.0.

TUESDAY April 26 - 10:00	
March	**ann. rate**
Consensus	775,000
Desjardins	765,000
February	**772,000**

New home sales (March) – Sales of new single-family homes have been slowing for a few months now. After rising sharply in late 2021, sales dropped 8.4% and 2.0%, respectively, in January and February. We expect sales to decline further in March given that the number of building permits issued that month for single-family homes fell 4.8%. Mortgage applications for home purchases are also down since the beginning of the year. However, builder confidence remains high despite declining slightly since December. We expect sales to dip from 772,000 to 765,000 units.

THURSDAY April 28 - 8:30	
Q1 2022	**ann. rate**
Consensus	1.0%
Desjardins	1.1%
Q4 2021	**6.9%**

Real GDP (Q1 – initial estimate) – Real GDP grew substantially in the fourth quarter of 2021, with production boosted by increased inventory accumulation. We expect that this effect will be partially reversed in the first quarter of 2022, weighing significantly on growth. We're also forecasting a negative contribution from international trade as real exports likely declined. (March's preliminary data on goods trade that will be released on Wednesday will give us more detail.) However, these negative factors will be offset by fairly strong growth in real consumption, which got a boost from January's solid figures. We also expect improvements in business investment and residential construction. Overall, we're forecasting an annualized 1.1% increase in real GDP, although final domestic demand could see a more than 4% gain.

CANADA

FRIDAY April 29 - 8:30	
February	**m/m**
Consensus	0.8%
Desjardins	0.8%
January	**0.2%**

Real GDP (February) – Real GDP is expected to advance by 0.8% m/m in February, in line with Statistics Canada's flash estimate and reflecting a solid performance in both the goods- and services-producing sectors. Looking to goods production, manufacturing and resource extraction are expected to stage meaningful comebacks in the month. At the same time, agriculture and construction are likely to advance again in February, albeit at a slower pace than in January. In services-producing sectors, reopening from Omicron lockdowns boosted activity in arts and culture as well as accommodation and food services. This came at the expense of retail and wholesale sales volumes, which contracted in February as consumers headed to bars instead of hunting for bargains. A print of this magnitude in February would all but lock in an advance in Q1 real GDP of around 4% (q/q, saar).

OVERSEAS

FRIDAY April 29 - 5:00	
April	**m/m**
Consensus	0.5%
March	**2.4%**

Eurozone: Consumer price index (April – preliminary) – Inflation accelerated sharply in the eurozone in February due to the surge in energy prices prompted by the war in Ukraine. It will be interesting to see whether this upward price trend continued in April and spread to other sectors or if inflation peaked.

FRIDAY April 29 - 5:00	
Q1 2022	**q/q**
Consensus	0.3%
Q4 2021	**0.3%**

Eurozone: Real GDP (Q1 – preliminary) – After sharp growth of 2.2% and 2.3% in the second and third quarters of 2021, real GDP in the eurozone slowed in the fourth quarter, expanding only 0.3%. Part of this slowdown was due to the arrival of the Omicron variant, which also impacted the beginning of 2022. Ongoing supply chain issues and rising energy prices, both of which have been exacerbated by the war in Ukraine, also probably tempered real GDP growth in the first quarter of 2022. As such, we're expecting more modest real GDP growth for early 2022, similar to what we saw in late 2021.

FRIDAY April 29 - 21:30	
April	
Consensus	48.0
March	**49.5**

China: PMI manufacturing index (April) – Lockdowns in major cities, especially Shanghai, impacted Chinese PMI indexes in March and suggest that supply chain issues are going to get even worse. However, Chinese industrial production was higher than expected in March. It will be interesting to see whether PMI indexes continue to slide or if the situation improves a little.

Economic Indicators

Week of April 25 to 29, 2022

Day	Hour	Indicator	Period	Consensus	Desjardins	Previous data
UNITED STATES						
MONDAY 25	---	---				
TUESDAY 26	8:30	Durable goods orders (m/m)	March	1.0%	1.1%	-2.1%
	9:00	S&P/Case-Shiller home price index (y/y)	Feb.	19.20%	18.90%	19.10%
	10:00	Consumer confidence	April	108.3	110.0	107.2
	10:00	New home sales (ann. rate)	March	775,000	765,000	772,000
WEDNESDAY 27	8:30	Goods trade balance – preliminary (US$B)	March	-105.0	-107.1	-106.3
	8:30	Retail inventories (m/m)	March	n/a	n/a	1.1%
	8:30	Wholesale inventories – preliminary (m/m)	March	1.8%	n/a	2.5%
	10:00	Pending home sales (m/m)	March	-0.5%	n/a	-4.1%
THURSDAY 28	8:30	Initial unemployment claims	April 18-22	180,000	182,000	184,000
	8:30	Real GDP (ann. rate)	Q1f	1.0%	1.1%	6.9%
FRIDAY 29	8:30	Employment cost index (q/q)	Q1	1.1%	1.1%	1.0%
	8:30	Personal income (m/m)	March	0.4%	0.3%	0.5%
	8:30	Personal consumption expenditures (m/m)	March	0.7%	0.9%	0.2%
	8:30	Personal consumption expenditures deflator				
		Total (m/m)	March	0.9%	0.9%	0.6%
		Excluding food and energy (m/m)	March	0.3%	0.2%	0.4%
		Total (y/y)	March	6.7%	6.7%	6.4%
		Excluding food and energy (y/y)	March	5.3%	5.2%	5.4%
	9:45	Chicago PMI index	April	61.5	62.5	62.9
	10:00	Michigan's consumer sentiment index – final	April	65.7	65.7	65.7
CANADA						
MONDAY 25	11:00	Speech of the Bank of Canada Governor, T. Macklem				
TUESDAY 26	8:55	Speech of a Bank of Canada Deputy Governor, T. Lane				
WEDNESDAY 27	---	---				
THURSDAY 28	---	---				
FRIDAY 29	8:30	Real GDP by industry (m/m)	Feb.	0.8%	0.8%	0.2%

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 25 to 29, 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 25							
Japan	1:00	Leading indicator – final	Feb.	n/a		100.9	
Japan	1:00	Coincident indicator – final	Feb.	n/a		95.5	
Germany	4:00	Ifo survey – Business climate	April	89.0		90.8	
Germany	4:00	Ifo survey – Current situation	April	95.9		97.0	
Germany	4:00	Ifo survey – Expectations	April	89.5		85.1	
Euro zone	5:00	Construction	Feb.	n/a	n/a	3.9%	4.1%
Japan	19:30	Unemployment rate	March	2.7%		2.7%	
TUESDAY 26							
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WEDNESDAY 27							
Japan	---	Bank of Japan meeting	April	-0.10%		-0.10%	
Germany	2:00	Consumer confidence	May	-16.0		-15.5	
France	2:45	Consumer confidence	April	91		91	
Japan	19:50	Industrial production – preliminary	March	0.5%	-1.4%	2.0%	0.5%
Japan	19:50	Retail sales	March	1.1%	0.3%	-0.8%	-0.8%
THURSDAY 28							
Japan	1:00	Housing starts	March		-0.5%		6.3%
Sweden	3:30	Bank of Sweden meeting	April	0.00%		0.00%	
Italy	4:00	Consumer confidence	April	100.0		100.8	
Italy	4:00	Economic confidence	April	n/a		105.4	
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	
Germany	8:00	Consumer price index – preliminary	April	0.6%	7.2%	2.5%	7.3%
FRIDAY 29							
France	1:30	Personal consumption expenditures	March	-0.2%	n/a	0.8%	-2.3%
France	1:30	Real GDP – preliminary	Q1	0.3%	5.6%	0.7%	5.4%
United Kingdom	2:00	Nationwide house prices	April	0.8%	12.6%	1.1%	14.3%
France	2:45	Consumer price index – preliminary	April	0.3%	4.6%	1.4%	4.5%
Euro zone	4:00	Money supply M3	March		6.2%		6.3%
Germany	4:00	Real GDP – preliminary	Q1	0.2%	3.8%	-0.3%	1.8%
Italy	4:00	Real GDP – preliminary	Q1	-0.3%	5.7%	0.6%	6.2%
Euro zone	5:00	Consumer price index – preliminary	April	0.5%	7.5%	2.4%	7.5%
Euro zone	5:00	Real GDP – preliminary	Q1	0.3%	5.1%	0.3%	4.6%
Italy	5:00	Consumer price index – preliminary	April	0.6%	6.7%	1.2%	6.7%
Russia	6:30	Bank of Russia meeting	April	15.00%		17.00%	
China	21:30	PMI manufacturing index	April	48.0		49.5	
China	21:30	PMI non-manufacturing index	April	46.2		48.4	

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).