WEEKLY COMMENTARY

Life after Rate Hikes

By Royce Mendes, Managing Director and Head of Macro Strategy

Traders will rejoice next week if US central bankers wave the white flag and signal the end of this latest rate hiking cycle. The Fed's aggressive campaign to tame inflation has sent markets reeling, so any relief would be received positively. But life after rate hikes isn't always what it's cracked up to be.

After rates peaked in the three most recent cycles, stock markets plunged, the economy faltered and Fed officials had to cut rates within nine months on average. Simply put, the end of rate hikes often coincides with the beginning of more severe pain.

That's because rate hikes only end when central bankers believe the economy has faced enough punishment. In fact, while it might not seem so at the time, policymakers often err on the side of too much punishment rather than too little. That seems to be true this time around as well.

The US labour market is still churning out jobs and companies are still profitable. Both households and businesses are proving more resilient than most forecasters expected. And there's at least a small chorus of voices still suggesting that the Fed needs to raise rates materially higher. But strength in the economy and financial system can quickly turn into weakness without much warning. In the past, after the economy had appeared more resistant to monetary tightening, rate hikes always eventually took their toll.

Just over two decades ago, in the year 2000, the Fed took rates all the way up to 6.50%. At the time, the consensus economic projection saw the US economy continuing to grow unencumbered in the following year. But, almost immediately after the final rate hike of that cycle, the yearslong rise in the S&P 500 reversed course, as did the strength in the economy. In the ensuing couple of years, the stock market declined almost 50% and the unemployment rate went up 2.5 percentage points.

It was a similar story following the final rate hike of the mid-2000s tightening cycle, which ended in 2006. The stock market continued to rise into 2007, then began to fall fast. By 2009, equity prices were down almost 50% from the date of the final rate hike and the economy was in the midst of the worst recession in almost a century.

It's true that the economic and financial market collapse not long after the final rate hike of the 2019 tightening cycle isn't relevant here since it was driven by the pandemic. But the economy was already on its back foot in late 2019 and early 2020. The financial system was facing challenges with the repo market, and the Fed had already been forced to cut rates. So it's very possible that the chain of events would have followed the previous examples were it not for COVID-19. We'll never know.

Today, there's ample reason to believe that Jay Powell and his colleagues have placed the economy on a similar track to those prior episodes. That's by design. The recent banking crisis has revealed cracks in the system and tightened financial conditions by an unknown amount. But with another 25bp rate increase in the offing next week, it's clear which way central bankers want to tilt the odds.

Whether it be next week or not, the end of this rate hiking cycle will imply that central bankers deem the outlook sufficiently gloomy. So whenever the Fed signals the end of this latest tightening campaign, traders might want to keep the champagne on ice because it might just be the beginning of a much more challenging environment.

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What to Watch For

By Randall Bartlett, Senior Director of Canadian Economics, Tiago Figueiredo, Associate – Macro Strategy, Marc Desormeaux, Principal Economist, Francis Généreux, Principal Economist, Marc-Antoine Dumont, Economist and Maëlle Boulais-Préseault, Economist

UNITED STATES

MONDAY, May 1 - 10:00	
April	**Index**
Consensus	46.8
Desjardins	45.9
March	**46.3**

ISM Manufacturing index (April) – After edging up in February on the heels of five straight monthly declines, the ISM Manufacturing index resumed its downward trend in March. The index fell to 46.3, its lowest level since the early months of the pandemic. Based on the regional manufacturing indexes published to date, it likely fell further in April, possibly to 45.9.

WEDNESDAY, May 3 - 10:00	
April	**Index**
Consensus	51.9
Desjardins	50.7
March	**51.2**

ISM Services index (April) – The ISM Services index slumped 3.9 points in March but remains above the 50 threshold. April's print will tell us whether March's dip was fleeting—like December's 6.3 point drop—or whether a clearer downward trend is taking hold. The consumer confidence indexes and regional non-manufacturing indicators published so far suggest that April's contraction will be modest. We expect the ISM Services index to fall to 50.7.

WEDNESDAY, May 3 - 14:00	
May	
Consensus	5.25%
Desjardins	5.25%
March 22	**5.00%**

Federal Reserve meeting (May) – At their March meeting, Federal Reserve officials dismissed some of the risks associated with the recent banking turmoil and tightened monetary policy further. Concerns about the strength of financial institutions have eased since mid-March, but some remain. Inflation continues to slow, but not quickly enough. As a result, we expect the Fed to raise rates another 25 basis points at its meeting on May 3. But it'll be interesting to see what kind of forward guidance the central bank and its chair Jerome Powell provide. Will we get a clear signal that this is the last interest rate hike, or will the Fed leave the door open to further tightening in the coming months?

FRIDAY, May 5 - 8:30	
April	
Consensus	180,000
Desjardins	190,000
March	**236,000**

Job creation according to the establishment survey (April) – Although hiring has dipped slightly since the beginning of the year, the labour market remains strong. March's 236,000 hires mean more than a million workers were added in the first quarter. But we think hiring slowed further in April. Mounting layoff announcements, the decline in hours worked in the past few months and the recent increase in unemployment claims point to slower job growth. That said, consumer confidence in the current job market remains very positive according to the Conference Board index. As such, we expect the April print to show just under 200,000 jobs added and the unemployment rate edging up to 3.6%.

CANADA

THURSDAY, May 4 - 8:30	
March	**$B**
Consensus	n/a
Desjardins	-0.5
February	**0.4**

International merchandise trade (March) – Canada's trade balance is expected to have fallen into negative territory in March, as exports seem to have eased while imports gained some ground. Strong preliminary data on US auto exports leads us to believe that Canadian motor vehicle and parts imports rose again in March. Based on that along with the depreciation of the Canadian dollar, we expect import prices and volumes to have climbed. On the export side, weakness in trade flows to our neighbour to the south may have been partly offset by a possible upside surprise in exports to other countries again this month. However, the risk to our forecast is titled to the downside as the broad-based downturn in goods prices likely continued to weigh on exports.

FRIDAY, May 5 - 8:30

April	
Consensus	n/a
Desjardins	15,000
March	**34,700**

Labour Force Survey (April) – There's little evidence to suggest that the Canadian labour market hit a rough patch in April. We expect momentum generally continued during the month, with another 15K jobs added. While that's not enough to stop the unemployment rate from ticking up to 5.1%, it would hardly represent the type of economic weakness that has long been anticipated. The ongoing labour dispute in the public sector is unlikely to impact the employment numbers as the survey was conducted before the strike began. Even if statisticians followed up later in the month, the dispute would have skewed total hours worked lower but not the employment data, since those workers would still have been considered employed. Meanwhile the annual wage rate is likely to remain above 5%, a level the Bank of Canada believes is inconsistent with 2% inflation. That said, central bankers have acknowledged that some of the recent hiring has come along with additional labour supply, so isn't necessarily putting upward pressure on inflation. As a result, market participants should focus more on the unemployment rate and wage trends than on the headline jobs numbers.

OVERSEAS

TUESDAY, May 2 - 5:00

April	**y/y**
Consensus	7.0%
March	**6.9%**

Eurozone: Consumer Price Index (April, preliminary) – Inflation continues to ease in the eurozone. After peaking at 10.6% in October, the 12-month change in the all items index retreated to 8.5% in February and 6.9% in March. This decline is mainly due to base effects, as energy prices are lower than they were a year ago. Energy prices were down 0.9% in the 12 months ending in March. Year-over-year, they were up more than 40% last fall. However, the all items less food and energy index continues to rise. April's print will tell us whether this dichotomy persists.

THURSDAY, May 4 - 8:15

May	
Consensus	3.75%
Desjardins	4.00%
March 16	**3.50%**

Eurozone: European Central Bank meeting (May) – Most analysts are pricing in another 25-basis point hike from the European Central Bank (ECB), following 50-basis point increases at its previous meetings. Given the strength of the economy, the lack of progress in tempering non-energy inflation, and some recent statements from ECB officials, we believe the chances of another 50bp hike are high. Remember too that the ECB started its monetary tightening cycle later, so it still has some catching up to do. That said, given the higher risk of financial instability, the ECB may opt to slow the pace of its rate hikes. But this wouldn't stop it from telegraphing further increases at future monetary policy meetings.

Economic Indicators

Week of May 1 to 5, 2023

Day	Time	Indicator	Period	Consensus		Previous reading
UNITED STATES						
MONDAY 1	10:00	Construction spending (m/m)	March	0.2%	-0.1%	-0.1%
	10:00	ISM Manufacturing index	April	46.8	45.9	46.3
TUESDAY 2	10:00	Factory orders (m/m)	March	1.4%	1.1%	-0.7%
	---	Total vehicle sales (ann. rate)	April	14,700,000	15,500,000	14,820,000
WEDNESDAY 3	10:00	ISM Services index	April	51.9	50.7	51.2
	14:00	Federal Reserve meeting	March	5.25%	5.25%	5.00%
	14:30	Speech by Federal Reserve Chair J. Powell				
THURSDAY 4	8:30	Initial unemployment claims	April 24–28	245,000	240,000	230,000
	8:30	Trade balance – goods and services (US$B)	March	-68.5	-62.8	-70.5
	8:30	Nonfarm productivity – preliminary (ann. rate)	Q1	0.1%	-2.8%	1.7%
	8:30	Unit labor costs – preliminary (ann. rate)	Q1	3.7%	5.9%	3.2%
FRIDAY 5	8:30	Change in nonfarm payrolls	April	180,000	190,000	236,000
	8:30	Unemployment rate	April	3.6%	3.6%	3.5%
	8:30	Average hourly earnings (m/m)	April	0.3%	0.2%	0.3%
	8:30	Average weekly hours	April	34.5	34.4	34.4
	13:00	Speech by Federal Reserve Bank of St. Louis President J. Bullard				
	13:00	Speech by Federal Reserve Governor L. Cook				
	15:00	Consumer credit (US$B)	March	17.250	15.000	15.290

CANADA						
MONDAY 1	---	---				
TUESDAY 2	---	---				
WEDNESDAY 3	---	---				
THURSDAY 4	8:30	International trade ($B)	March	n/a	-0.5	0.4
	12:50	Speech by Bank of Canada Governor T. Macklem				
FRIDAY 5	8:30	Net change in employment	April	n/a	15,000	34,700
	8:30	Unemployment rate	April	n/a	5.1%	5.0%

Note: Each week, Desjardins Economic Studies takes part 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 month-over-month, quarter-over-quarter and year-over-year change respectively. Following the quarter, the abbreviations f, s and t correspond to first estimate, second estimate and third estimate respectively. Times shown are daylight saving time (GMT - 4 hours). Desjardins Economic Studies forecast.

Economic Indicators

Week of May 1 to 5, 2023

Country	Time	Indicator	Period	Consensus m/m (q/q)	Consensus y/y	Previous reading m/m (q/q)	Previous reading y/y
OVERSEAS							
MONDAY 1							
Japan	1:00	Consumer confidence	April	34.8		33.9	
TUESDAY 2							
Australia	00:30	Reserve Bank of Australia meeting	May	3.60%		3.60%	
United Kingdom	2:00	Nationwide house prices	April	-0.4%	-3.6%	-0.8%	-3.1%
Germany	2:00	Retail sales	March	0.4%	-6.5%	-1.3%	-7.0%
Italy	3:45	Manufacturing PMI	April	49.5		51.1	
France	3:50	Manufacturing PMI – final	April	45.5		45.5	
Germany	3:55	Manufacturing PMI – final	April	44.0		44.0	
Eurozone	4:00	Manufacturing PMI – final	April	45.5		45.5	
Eurozone	4:00	M3 money supply	March		2.4%		2.9%
United Kingdom	4:30	Manufacturing PMI – final	April	46.6		46.6	
Eurozone	5:00	Consumer price index – preliminary	April	0.7%	7.0%	0.9%	6.9%
Italy	5:00	Consumer price index – preliminary	April	n/a	7.2%	-0.3%	7.7%
WEDNESDAY 3							
Eurozone	5:00	Unemployment rate	March	6.6%		6.6%	
Brazil	17:30	Central Bank of Brazil meeting	May	13.75%		13.75%	
Japan	20:30	Composite PMI – final	April	n/a		52.5	
THURSDAY 4							
Germany	2:00	Trade balance (€B)	March	16.0		16.0	
Italy	3:45	Composite PMI	April	55.9		55.2	
Italy	3:45	Services PMI	April	56.9		55.7	
France	3:50	Composite PMI – final	April	53.8		53.8	
France	3:50	Services PMI – final	April	56.3		56.3	
Germany	3:55	Composite PMI – final	April	53.9		53.9	
Germany	3:55	Services PMI – final	April	55.7		55.7	
Eurozone	4:00	Composite PMI – final	April	54.4		54.4	
Eurozone	4:00	Services PMI – final	April	56.6		56.6	
Norway	4:00	Bank of Norway meeting	May	3.25%		3.00%	
United Kingdom	4:30	Composite PMI – final	April	53.9		53.9	
United Kingdom	4:30	Services PMI – final	April	54.9		54.9	
Eurozone	5:00	Producer price index	April	-1.8%	5.7%	-0.5%	13.2%
Eurozone	8:15	European Central Bank meeting	May	3.75%		3.50%	
FRIDAY 5							
Germany	2:00	Factory orders	March	-2.4%	-3.1%	4.8%	-5.7%
France	2:45	Wages – preliminary	Q1	n/a		0.7%	
France	2:45	Industrial production	March	-0.5%	1.1%	1.2%	1.3%
Italy	4:00	Retail sales	March	n/a	n/a	-0.1%	5.8%
Eurozone	5:00	Retail sales	March	-0.2%	-3.1%	-0.8%	-3.0%

NOTE: Unlike release times for US and Canadian economic data, release times for overseas economic data are approximate. Publication dates are provided for information only. The abbreviations m/m, q/q and y/y correspond to month-over-month, quarter-over-quarter and year-over-year change respectively. Times shown are daylight saving time (GMT - 4 hours).