# WEEKLY COMMENTARY

# Revving the Rate Hike Engine

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

Central bankers hoping to have done enough to quell underlying inflation pressures are now facing discouraging developments. What stood out the most in Canada's first quarter GDP report was not even the actual result. While growth did come in way above the latest Bank of Canada forecast, and also above the median consensus estimate, it was only two-tenths higher than our own prediction. The more surprising revelation came from the flash reading for April (+0.2%). This suggests that the combined impact of the ice storm and public servant strike might not have been as significant as initially anticipated. Alternatively, it is possible that these events did have an impact, but the strength of other sectors of the economy was enough to offset their effects. In any event, the solid handoff will force us to revise our second quarter forecast to the upside by a meaningful extent.

Should the BoC lose its cool about these developments? One could argue that a significant portion of the economic strength can be attributed to the continuous deliveries of trucks and SUVs, with consumer spending in this category surging by an astonishing annualized rate of 35%. Additionally, the expiration of various affordability support measures resulted in a substantial decline in government transfers to households, leading to lower disposable income and savings rates. In other words, the news on spending power was not all that bad. Moreover, mortgage renewals are also putting pressure on household finances. Even though the impact is somewhat mitigated by the flexibility offered by mortgage lenders (as our analysis has shown), lenders are tightening credit, and in an economy like Canada's where the credit cycle has provided significant tailwinds over the past 13 years, this shift will have non-trivial implications.

However, these factors should not be seen as a reason for the BoC to disregard data suggesting that the slowdown in inflation observed since the summer of 2022 is reaching a plateau. This is particularly evident in core inflation, where improvements have been more modest, with shorter-term indicators seemingly stuck at 3.5%. In the April meeting's summary of deliberations, the Bank specifically mentioned the "resilience of economic growth and the persistence of elevated core inflation" as factors supporting an instant rate hike. Taking this statement into account, along with the strength observed in other data such as the rebound in three-month annualized hourly wage growth and the pickup in home sales, the case for a rate hike as soon as next week builds even further.

But while we wouldn't rule that out as a possibility, we view a move in July as more likely for a few reasons. First, the effects of tighter credit in North America still need to be taken into proper consideration. More restricted lending could have an impact similar to another rate hike, or possibly more. This is also why we lean towards incorporating only one more hike at this point. This should be seen as an exercise in risk management amid high uncertainty rather than a predetermined series of hikes. Second, market expectations still lean towards maintaining the status quo for the upcoming meeting. Surprising the market with a rate hike could lead to speculation about follow-up moves and tighten financial conditions to a degree that the BoC may not be comfortable with just yet, especially in light of the vulnerabilities it recently spelled out in its Financial System Review. And third, even though the US debt ceiling standoff has been resolved favourably, there may still be consequences stemming from a cash-strapped US Treasury that is just about to flood markets with the issuance of Treasury bills and notes. This could potentially impact Canadian funding markets, making it ill-advised to raise rates in this environment. As a result, what we envision for next week is a Bank of Canada revving the hike engine without putting it in gear just yet.

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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, June 5 - 10:00

| | |
|---|---|
| **May** | **Index** |
| Consensus | 52.5 |
| Desjardins | 51.9 |
| **April** | **51.9** |

**ISM Services index (May) –** The ISM Services index eked out a 0.7-point gain in April after plummeting 3.9 points in March. We're expecting May's print to be fairly flat. While the main consumer confidence indexes have deteriorated, regional non-manufacturing indexes suggest some stability in the ISM Services index.

WEDNESDAY, June 7 - 15:00

| | |
|---|---|
| **April** | **US$B** |
| Consensus | 21.600 |
| Desjardins | 30.000 |
| **March** | **26.514** |

**Consumer credit (April) –** The turmoil rattling the banking sector since March seems to have had little impact on consumer credit. We expect the sector to have had another solid month based on the weekly data published by commercial banks, higher motor vehicle sales in April, gains in retail sales and the lower household savings rate.

## CANADA

WEDNESDAY, June 7 - 8:30

| | |
|---|---|
| **April** | |
| Consensus | n/a |
| Desjardins | $0.9B |
| **March** | **$1.0B** |

**International merchandise trade (April) –** Canada's trade balance is expected to have stayed in positive territory in April. Inputs into our forecast suggest that exports rose on strong auto production and higher WCS prices. On the import side, the projected increase is a price story, as the depreciation of the Canadian dollar likely pushed import costs higher while volumes are forecast to have been slightly negative. That said, the increase in imports is not expected to have offset the advance in exports in March.

WEDNESDAY, June 7 - 10:00

| | |
|---|---|
| **June** | |
| Consensus | 4.50% |
| Desjardins | 4.50% |
| **April 12** | **4.50%** |

**Bank of Canada policy rate (June) –** Monetary policymakers will be seriously considering whether to raise rates next week, but we ultimately believe they will stand pat. By issuing a very hawkish statement on June 7 to describe their view of the economy and inflation, the central bank can prepare Canadians for higher interest rates before actually pulling the trigger. Eschewing a move next week would also give them a bit more time to survey the impacts of past monetary policy tightening and monitor liquidity conditions in the US. That said, we certainly can't rule out a rate hike on June 7. It's almost a coin flip at this point.

FRIDAY, June 9 - 8:30

| | |
|---|---|
| **May** | |
| Consensus | n/a |
| Desjardins | 30,000 |
| **April** | **41,400** |

**Labour Force Survey (May) –** The combination of strong demand for labour and record population growth likely kept Canada's job creation machine humming in May. We expect the economy churned out another 25K jobs during the month as job vacancies were further filled by newcomers to the country. As a result of the increase in labour supply, we don't expect the unemployment rate to have fallen in May despite the solid advance in employment. It's possible that the year-over-year pace of wage growth accelerated in May. However, the three-month annualized rate has been looking more subdued in recent months, which takes at least some pressure off of the central bank to react immediately to the hotter inflationary pressures showing up in other data.

## OVERSEAS

WEDNESDAY, June 7 - 2:00

| | |
|---|---|
| **April** | **m/m** |
| Consensus | 0.6% |
| **March** | **-3.4%** |

**Germany: Industrial production (April) –** German industrial production had its worst month in a year in March. Most of the indicator's components also slumped. Although production tends to be volatile from month to month, March's 10.7% plunge in manufacturing orders and Germany's weak manufacturing PMI—44.5 in April and 43.2 in March—don't suggest an imminent rebound.

THURSDAY, June 8 - 21:30

| May | y/y |
|---|---|
| Consensus | 0.2% |
| **April** | **0.1%** |

**China: Consumer price index (May) –** Of all the problems facing the Chinese economy, inflation isn't one of them. While most advanced economies are still grappling with excessive price growth, China's inflation was just 0.1% in April. In fact, since China's economy reopened in late 2022, price growth has slowed. However, at 0.7%, inflation excluding energy and food was a bit stickier last month, partly due to the more services-focused nature of the economic rebound. Will China remain immune to inflationary pressure or suffer later on?

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# Economic Indicators

## Week of June 5 to 9, 2023

| Day | Time | Indicator | Period | Consensus | | Previous reading |
|---|---|---|---|---|---|---|
| **UNITED STATES** | | | | | | |
| MONDAY 5 | 10:00 | Factory orders (m/m) | April | 0.8% | 0.0% | 0.9% |
| | 10:00 | ISM Services index | May | 52.5 | 51.9 | 51.9 |
| TUESDAY 6 | --- | --- | | | | |
| WEDNESDAY 7 | 8:30 | Trade balance – goods and services (US$B) | April | -75.3 | -77.6 | -64.2 |
| | 15:00 | Consumer credit (US$B) | April | 21.600 | 30.000 | 26.514 |
| THURSDAY 8 | 8:30 | Initial unemployment claims | May 29–June 2 | 236,000 | 237,000 | 232,000 |
| | 10:00 | Wholesale inventories – final (m/m) | April | -0.2% | -0.2% | -0.2% |
| FRIDAY 9 | --- | --- | | | | |

| Day | Time | Indicator | Period | Consensus | | Previous reading |
|---|---|---|---|---|---|---|
| **CANADA** | | | | | | |
| MONDAY 5 | --- | --- | | | | |
| TUESDAY 6 | 8:30 | Building permits (m/m) | April | n/a | -7.9% | 11.3% |
| WEDNESDAY 7 | 8:30 | International trade ($B) | April | n/a | 0.9 | 1.0 |
| | 8:30 | Labour productivity (q/q) | Q1 | n/a | -0.4% | -0.5% |
| | 10:00 | Bank of Canada meeting | June | 4.50% | 4.50% | 4.50% |
| THURSDAY 8 | 15:10 | Speech by Bank of Canada Deputy Governor P. Beaudry | | | | |
| FRIDAY 9 | 8:30 | Net change in employment | May | n/a | 30,000 | 41,400 |
| | 8:30 | Unemployment rate | May | n/a | 5.0% | 5.0% |
| | 8:30 | Industrial capacity utilization rate | Q1 | n/a | 82.9% | 81.7% |

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 June 5 to 9, 2023

| Country | Time | Indicator | Period | Consensus m/m (q/q) | Consensus y/y | Previous reading m/m (q/q) | Previous reading y/y |
|---|---|---|---|---|---|---|---|
| **OVERSEAS** | | | | | | | |
| **SUNDAY 4** | | | | | | | |
| Japan | 20:30 | Composite PMI – final | May | n/a | | 54.9 | |
| Japan | 20:30 | Services PMI – final | May | n/a | | 56.3 | |
| **MONDAY 5** | | | | | | | |
| Germany | 2:00 | Trade balance (€B) | April | 16.0 | | 16.7 | |
| Italy | 3:45 | Composite PMI | May | 54.6 | | 55.3 | |
| Italy | 3:45 | Services PMI | May | 57.0 | | 57.6 | |
| France | 3:50 | Composite PMI – final | May | 51.4 | | 51.4 | |
| France | 3:50 | Services PMI – final | May | 52.8 | | 52.8 | |
| Germany | 3:55 | Composite PMI – final | May | 54.3 | | 54.3 | |
| Germany | 3:55 | Services PMI – final | May | 57.8 | | 57.8 | |
| Eurozone | 4:00 | Composite PMI – final | May | 53.3 | | 53.3 | |
| Eurozone | 4:00 | Services PMI – final | May | 55.9 | | 55.9 | |
| United Kingdom | 4:30 | Composite PMI – final | May | 53.9 | | 53.9 | |
| United Kingdom | 4:30 | Services PMI – final | May | 55.1 | | 55.1 | |
| Eurozone | 5:00 | Producer price index | May | -2.9% | 1.8% | -1.6% | 5.9% |
| **TUESDAY 6** | | | | | | | |
| Australia | 00:30 | Reserve Bank of Australia meeting | June | 3.85% | | 3.85 % | |
| Germany | 2:00 | Factory orders | April | 2.8% | -8.6% | -10.7% | -11.0% |
| Eurozone | 5:00 | Retail sales | April | 0.2% | -2.8% | -1.2% | -3.8% |
| **WEDNESDAY 7** | | | | | | | |
| China | --- | Trade balance (US$B) | May | 94.15 | | 90.21 | |
| Japan | 1:00 | Leading indicator – preliminary | April | 98.2 | | 97.7 | |
| Japan | 1:00 | Coincident index – preliminary | April | 99.0 | | 98.8 | |
| Germany | 2:00 | Industrial production | April | 0.6% | 1.4% | -3.4% | 1.8% |
| France | 2:45 | Trade balance (€M) | April | n/a | | -8,023 | |
| France | 2:45 | Current account (€B) | April | n/a | | 1.4 | |
| Italy | 4:00 | Retail sales | April | 0.3% | n/a | 0.0% | 5.8% |
| Japan | 19:50 | Real GDP – final | Q1 | 0.5% | | 0.4% | |
| Japan | 19:50 | Current account (¥B) | April | 1,384.4 | | 1,009.0 | |
| Japan | 19:50 | Trade balance (¥B) | April | -295.1 | | -454.4 | |
| **THURSDAY 8** | | | | | | | |
| Eurozone | 5:00 | Real GDP – final | Q1 | 0.0% | 1.3% | 0.1% | 1.3% |
| Eurozone | 5:00 | Net change in employment – final | Q1 | n/a | n/a | 0.6% | 1.7% |
| China | 21:30 | Consumer price index | May | | 0.2% | | 0.1% |
| China | 21:30 | Producer price index | May | | -4.2% | | -3.6% |
| **FRIDAY 9** | | | | | | | |
| Italy | 4:00 | Industrial production | April | 0.2% | -4.1% | -0.6% | -3.2% |

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).