

WEEKLY COMMENTARY

Inflation in Canada Is Always and Everywhere the Bank of Canada’s Problem

By Randall Bartlett, Senior Director of Canadian Economics

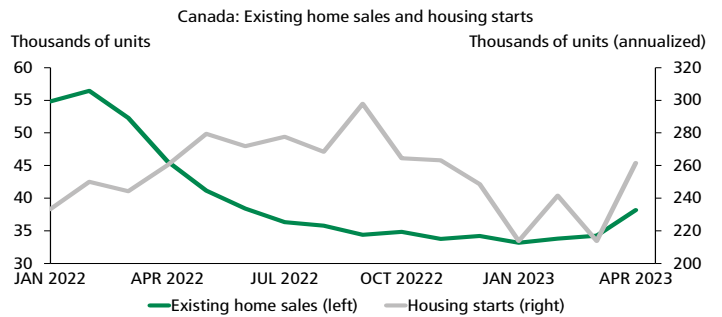
With this week’s 25 basis point rate hike, the Bank of Canada left no doubt where it stands. It’s the central bank’s [view](#) that “excess demand in the economy looks to be more persistent than anticipated.” However, “the Bank remains resolute in its commitment to restoring price stability for Canadians.” This leaves the door open to another hike in July if the economy doesn’t start changing direction before then.

We are skeptical that the Canadian economy will lose much momentum in the lead-up to the Bank of Canada’s July interest rate announcement for a few reasons.

Real GDP growth not only surprised on the upside in the first quarter of 2023—coming in at 3.1% q/q annualized versus the Bank of Canada’s 2.3% forecast—but Statistics Canada’s flash estimate for April was much higher than expected. While a +0.2% m/m print typically isn’t much to write home about, this included the drag from both the ice storms in Central Canada and the federal public service strike. As such, if these two one-off events had not occurred, real GDP growth in April would have been even stronger. Add to this the fact that May real GDP will reflect a rebound in the sectors negatively affected by these events in April, and momentum in economic activity should persist well into Q2.

Speaking of May real GDP, high-frequency economic indicators have suggested energy production may not have been severely impacted by the wildfires in Alberta. From petroleum production and US crude imports to rig counts and crude by rail, the energy sector looks to have posted a modest gain in the month after a bumper April. Indeed, from a real GDP by industry perspective, mining and oil and gas extraction is gearing up to be a growth leader in Q2.

GRAPH 1
Residential Investment Rebounded Sharply in April



Sources: Canadian Real Estate Association, Canada Mortgage and Housing Corporation and Desjardins Economic Studies

And while we would have expected the interest-rate-sensitive housing market to still be in the dumps given elevated borrowing costs, existing home sales defied gravity in April and—as far as we can tell—in May too (graph 1). Housing starts have maintained surprising momentum as well. However, as we [wrote](#) recently, there is a not insignificant share of Canadian homeowners with fixed-payment variable-rate mortgages that have yet to feel the impacts of rate hikes. This is because some financial institutions have allowed them to add any additional monthly amounts beyond their fixed payment to their mortgage principal. But one can only kick the housing correction can down the road so far. Ultimately, lenders will want to get paid.

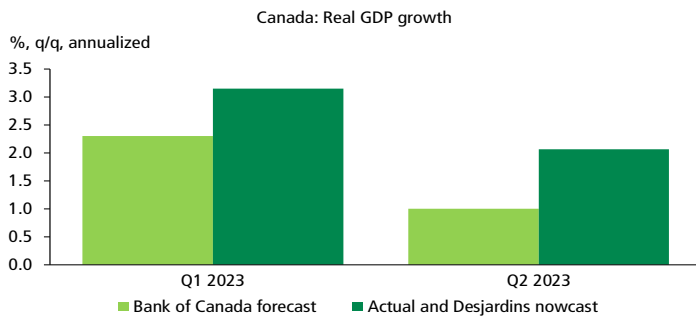
Taken together, our nowcast is pointing to a Q2 real GDP growth print of close to 2.0% annualized (graph 2 on page 2). Even if this proves to be a little ambitious, it suggests an advance that is well above the 1.0% published in the Bank of Canada’s April 2023 Monetary Policy Report (MPR). And some of that

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GRAPH 2
Canada's Economy Is Growing Faster than the Bank Expected



Sources: Bank of Canada, Statistics Canada and Desjardins Economic Studies

momentum is likely to carry into Q3, pushing a possible recession further out into the future.

But it's not just real GDP. The labour market hasn't been playing ball either. And while today's jobs report for May showed employment took a step back in the month, it is just one data point in a still extremely tight labour market. Given the surging population growth and elevated job vacancy rate we're seeing, there's reason to expect employment to perk back up.

That brings us to inflation. While headline price growth inched up to 4.4% in April, it's expected to track lower when we get the latest data for May. But total CPI isn't the price measure currently commanding the Bank's attention. Instead, the Bank of Canada is looking at a suite of indicators of underlying CPI inflation—such as the trimmed mean, median and services inflation excluding shelter—that provide a more fulsome perspective on price pressures in Canada. These continue to be concerning, being stuck in the range of 3.5% to 4.5%. And with inflation expectations having moved higher since the April MPR, the Bank's job of bringing inflation back to 2.0% looks to be getting harder by the day.

This poses a significant challenge for the Bank of Canada—one that prompted the rate hike this week and will likely lead to another in July and possibly more thereafter. But, to egregiously misquote Milton Friedman, inflation in Canada is always and everywhere the Bank of Canada's problem.

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

TUESDAY, June 13 - 8:30

May	m/m
Consensus	0.2%
Desjardins	0.1%
April	0.4%

WEDNESDAY, June 14 - 14:00

June	
Consensus	5.25%
Desjardins	5.25%
May 3	5.25%

THURSDAY, June 15 - 8:30

May	m/m
Consensus	0.0%
Desjardins	-0.6%
April	0.4%

THURSDAY, June 15 - 9:15

May	m/m
Consensus	0.1%
Desjardins	0.3%
April	0.5%

FRIDAY, June 16 - 10:00

June	Index
Consensus	60.0
Desjardins	63.0
May	59.2

UNITED STATES

Consumer price index (May) – After nearly a year of falling inflation, the decline eased up in April, with the year-over-year change in the consumer price index only dropping from 5.0% to 4.9%. We’re expecting something more substantial from May. Falling energy prices should help, with the year-over-year picture already favourable and a big month-over-month drop expected. Pump prices fell 1.7% in May, a month which usually sees them tick up, which means seasonal adjustments should bring it down further. Stripping out food and energy, we expect to see a 0.4% increase for May, just like the previous two months. We’re forecasting a month-over-month rise in the all items index of just 0.1%. The year-over-year change in the all items index should fall from 4.9% to 4.1%, with core inflation edging down from 5.5% to 5.2%.

Federal Reserve meeting (June) – By announcing a 25 basis point rate hike in early May, Fed officials suggested that it might be the last one, or at least that a pause was in the cards. But that possibility seems difficult to reconcile with the economic data that’s since been published. Inflation remains high, particularly on the core side, and the labour market is still hot, adding 339,000 jobs in May. The banking sector turmoil has also largely subsided and a debt ceiling debacle has been avoided, all of which leaves us skeptical that May’s increase will be the last. Still, some Fed officials have signalled support for a pause in June. It’s likely to be a difficult decision, with disagreement among members of the FOMC. Our money is on a pause, but we also wouldn’t be surprised by another hike, especially given the Bank of Canada’s decision this week. We’ll also be interested to see what Fed officials are now forecasting for the economy, inflation and future rate changes.

Retail sales (May) – After suffering consecutive monthly declines of 0.7% in February and March, retail sales picked up 0.4% in April. We expect another slump in May. That’s based on a decline in new motor vehicle sales, falling gasoline prices (which will bring down gasoline station receipts) and preliminary card transaction data. All in all, we expect a 0.6% contraction in total retail sales and a 0.3% decline in sales excluding motor vehicles and gasoline.

Industrial production (May) – Despite a weak ISM Manufacturing index, US manufacturing doesn’t seem to be doing too badly. After a flat February and March, industrial production grew 0.5% in April, despite a big drop in energy production. Another increase is being projected for May. We’re encouraged by strong growth in hours worked in the automotive sector, although we anticipate more modest production gains in the rest of the manufacturing sector. The mining sector should deliver strong numbers, but we expect another drop in energy production. Overall, we’re forecasting a 0.3% increase in industrial production.

University of Michigan consumer sentiment index (June – preliminary) – The first two quarters of 2023 have so far been difficult for consumer sentiment. The University of Michigan index shed 5.0 points in March and another 4.3 in May, picking up a measly 1.5 points in between in April. We’re particularly eager to see the preliminary data for June, now that the debt ceiling saga is behind us and no longer weighing on markets and households. The stock market has been up since late May, gasoline prices are trending down and banking fears seem to have subsided. The only flies in the ointment are higher interest rates and persistent concerns about the real health of the economy. We still expect consumer sentiment to have improved in early June and to see the University of Michigan index back above 60.

THURSDAY, June 15 - 8:15

May	Ann. rate
Consensus	n/a
Desjardins	225,000
April	261,600

THURSDAY, June 15 - 8:30

April	m/m
Consensus	n/a
Desjardins	-0.4%
March	0.7%

THURSDAY, June 15 - 9:00

May	m/m
Consensus	n/a
Desjardins	12.1%
April	11.3%

WEDNESDAY, June 14 - 2:00

April	m/m
Consensus	0.2%
March	-0.3%

WEDNESDAY, June 14 - 22:00
THURSDAY, June 15

June	
Consensus	-0.10%
April 28	-0.10%

THURSDAY, June 15 - 8:15

June	
Consensus	4.00%
May 4	3.75%

CANADA

Housing starts (May) – After a blowout move higher in April, housing starts are expected to see a more muted May print. The sustained slowing in building permits suggests as much. And while the recent rebound in existing home sales should provide a tailwind to new construction, the resumption of interest rate hikes by the Bank of Canada should prove to be a headwind to housing market activity more broadly.

Manufacturing sales (April) – Manufacturing sales are expected to continue their ups and downs, as a decrease in April should follow the March increase. Sales volumes are forecast to be slightly positive, but not enough to offset lower prices. Exports of metal and non-metallic mineral products and motor vehicles and parts surged in April, pointing to higher manufacturing sales in these sectors. Our projected weakness in total manufacturing sales is less than the -0.2% flash estimate from Statistics Canada.

Existing home sales (May) – Another month, another anticipated sharp increase in existing home sales. But if April was driven by outsized gains in Toronto (27%) and Vancouver (25%), May's advance is expected to be much more broad-based. Specifically, the Toronto Regional Real Estate Board (TRREB) has estimated that residential sales transactions advanced a still-respectable 5.2% m/m in May. However, mapping year-over-year gains in other Ontario communities to the seasonally-adjusted monthly data points to even more upside, particularly in Ottawa and around the Greater Toronto Area. The picture is similar in other parts of the country where we have data. That said, the data is from before the Bank of Canada's latest rate hike, and so we may see a loss in momentum going forward.

OVERSEAS

United Kingdom: Monthly GDP (April) – While revised real GDP figures now show the eurozone slipped into a mild recession in Q1 2023, the UK economy managed to avoid a second consecutive contraction. It did still end the quarter on a sour note, though, with monthly real GDP falling 0.3% for March. However, we would be shocked to see another decline of that magnitude for April. While there may have been other difficulties in the manufacturing sector, there are promising signs from the Services PMI, not to mention a 0.8% pickup in retail sales excluding gasoline in April.


China: Industrial production and retail sales (May) – Year-over-year changes in industrial production and retail sales weren't as strong as expected in April, despite a favourable comparison with Q2 2022, when many cities were locked down. May data will confirm whether China's economic rebound is in trouble or if April was an isolated stumble.


Japan: Bank of Japan meeting (June) – After a prolonged period of deflation or very low inflation, rising prices are now a concern for Japan, and not only in terms of food and energy. Inflationary pressure appears to have become widespread. Looking at the annualized three-month change in non-food and non-energy prices, core inflation is now near 6%. That's comparable to what's being observed in other major economies, although there are still limited pressures on wages in Japan. That said, it seems increasingly likely that the Bank of Japan will soon either raise its policy interest rate or change its long-term yield control policy. Rising inflation is making it difficult to pursue ultra-accommodative monetary policy, and a change would benefit the yen and bring down import prices.

Eurozone: European Central Bank meeting (June) – The European Central Bank (ECB) slowed the pace of rate hikes at its last monetary policy meeting, but that doesn't mean the tightening cycle is over. Inflation is still too high. Expectations are for another 25 basis point increase on June 15. The ECB will probably also leave the door open to further hikes over the summer. It will be interesting to see how its forecasts have changed.

Economic Indicators

Week of June 12 to 16, 2023

Day	Time	Indicator	Period	Consensus		Previous reading
UNITED STATES						
MONDAY I2	14:00	Federal budget (US\$B)	May	-236.0	-236.0	-176.2
TUESDAY I3	8:30	Consumer price index				
		Total (m/m)	May	0.2%	0.1%	0.4%
		Excluding food and energy (m/m)	May	0.4%	0.4%	0.4%
		Total (y/y)	May	4.1%	4.1%	4.9%
		Excluding food and energy (y/y)	May	5.3%	5.2%	5.5%
WEDNESDAY I4	8:30	Producer price index				
		Total (m/m)	May	-0.1%	-0.3%	0.2%
		Excluding food and energy (m/m)	May	0.2%	0.0%	0.2%
	14:00	Federal Reserve meeting	June	5.25%	5.25%	5.25%
	14:30	Speech by Federal Reserve Chair J. Powell				
THURSDAY I5	8:30	Initial unemployment claims	June 5–9	250,000	251,000	261,000
	8:30	Empire State Manufacturing Index	June	-15.0	-17.0	-31.8
	8:30	Philadelphia Fed index	June	-13.3	-17.0	-10.4
	8:30	Retail sales				
		Total (m/m)	May	0.0%	-0.6%	0.4%
		Excluding automobiles (m/m)	May	0.1%	-0.5%	0.4%
	8:30	Export prices (m/m)	May	0.0%	-1.5%	0.2%
	8:30	Import prices (m/m)	May	-0.6%	-1.0%	0.4%
	9:15	Industrial production (m/m)	May	0.1%	0.3%	0.5%
	9:15	Production capacity utilization rate	May	79.7%	79.9%	79.7%
	10:00	Business inventories (m/m)	April	0.2%	0.2%	-0.1%
FRIDAY I6	10:00	University of Michigan consumer sentiment index – preliminary	June	60.0	63.0	59.2
CANADA						
MONDAY I2	---	---				
TUESDAY I3	---	---				
WEDNESDAY I4	---	---				
THURSDAY I5	8:15	Housing starts (ann. rate)	May	n/a	225,000	261,600
	8:30	Manufacturing sales (m/m)	April	n/a	-0.4%	0.7%
	9:00	Existing home sales (m/m)	May	n/a	12.1%	11.3%
FRIDAY I6	8:30	Wholesale sales (m/m)	April	n/a	0.4%	-0.1%

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 12 to 16, 2023

Country	Time	Indicator	Period	Consensus		Previous reading	
				m/m (q/q)	y/y	m/m (q/q)	y/y
OVERSEAS							
SUNDAY 11							
Japan	19:50	Producer price index	May	-0.2%	5.6%	0.2%	5.8%
MONDAY 12							
---	---						
TUESDAY 13							
Germany	---	Current account (€B)	April	n/a		32.4	
United Kingdom	2:00	ILO unemployment rate	April	4.0%		3.9%	
Germany	2:00	Consumer price index – final	May	-0.1%	6.1%	-0.1%	6.1%
Germany	5:00	ZEW Current Conditions Survey	June	-41.0		-34.8	
Germany	5:00	ZEW Expectations Survey	June	-13.5		-10.7	
WEDNESDAY 14							
United Kingdom	2:00	Monthly GDP	April	0.2%		-0.3%	
United Kingdom	2:00	Industrial production	April	-0.1%	-1.8%	0.7%	-2.0%
United Kingdom	2:00	Index of services	April	0.3%		-0.5%	
United Kingdom	2:00	Construction	April	0.0%	4.3%	0.2%	4.1%
United Kingdom	2:00	Trade balance (€M)	April	-3,600		-2,864	
Eurozone	5:00	Industrial production	April	0.8%	0.7%	-4.1%	-1.5%
Japan	19:50	Trade balance (¥B)	May	-811.1		-1,017.2	
China	22:00	Industrial production	May		3.5%		5.6%
China	22:00	Retail sales	May		13.7%		18.4%
THURSDAY 15							
Japan	---	Bank of Japan meeting	June	-0.10%		-0.10%	
Japan	00:30	Tertiary Industry Activity Index	April	0.4%		-1.7%	
France	2:45	Consumer price index – final	May	-0.1%	5.1%	-0.1%	5.1%
Eurozone	5:00	Trade balance (€B)	April	5.0		17.0	
Eurozone	8:15	European Central Bank meeting	June	4.00%		3.75%	
FRIDAY 16							
Eurozone	5:00	Consumer price index – final	May	0.0%	6.1%	0.0%	6.1%
Italy	5:00	Trade balance (€M)	April	n/a		7,541	

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).