

WEEKLY COMMENTARY

Inflation Is Eating into the Profitability of a Growing Number of Canadian Businesses

By H el ene B egin, Senior Economist

Households and businesses are feeling the pinch of rapidly rising prices. Costs have been going up for businesses since last year. Everything from transportation to inputs and wages is costing more, eroding profitability. Many businesses are passing on these higher costs to consumers, fuelling inflation in the wider economy.

Here in Canada, commodity prices were up 38.4% in April year over year. Prices for industrial products (materials purchased by businesses to make other goods) jumped 16.4%. But businesses aren't just facing higher input costs. They're also dealing with higher prices for air, land and sea transportation, driving up supply and distribution costs in most industries.

Then there's wage growth. Unemployment peaked in spring of 2020. But workers have been scarce since shortly after the pandemic began. In Canada, the jobless rate fell to 5.2% in April, while average hourly wages were up 3.3% on the year. In Quebec, unemployment hit a record low 3.9%, with average hourly wages surging more than 5.7% since last April. The labour shortage is forcing businesses to hike wages as workers demand bigger raises to keep up with inflation.

In short, the cost of doing business has gone up dramatically due to a number of factors that will be with us for months to come. How will businesses respond? According to a Statistics Canada [survey](#), over a third of businesses intend to raise their prices this spring, but plans vary by sector. The majority of businesses in the accommodation and food services (56.7%), manufacturing (55.7%), wholesale (52.8%) and retail (51.7%) sectors plan to bump up prices.

According to an April survey by the Canadian Federation of Independent Business, SMEs think they'll have to hike prices nearly 5% on average over the next year. That means they'll try to pass on some of their higher costs if they can't offset them by boosting productivity. According to Statistics Canada, about a third of Canadian businesses expect their profits to shrink this spring.

In the StatCan survey, about three quarters of businesses said they have enough cash on hand to stay afloat for three months. A quarter do not. Business insolvencies in Canada declined 24.3% in 2020 and 11.0% in 2021 thanks to government and financial institution relief measures. But they're on the rise again, and we expect that trend to continue in the coming months. To top it all off, borrowing will become more expensive as interest rates go up. Just one more challenge for highly leveraged businesses and sectors with already slim profit margins.

CONTENT

Musing of the Week	1	Week in Review	2	What to Watch For	3	Economic Indicators.....	4
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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

- ▶ **Inflation can erode the profitability of businesses**, especially those that fail to pass on rising costs to consumers. That's why investors were disappointed with the results of some major US retailers this week. The S&P 500 lost more than 4% on Wednesday, and weaker risk appetite drove bond yields lower this week as recession fears also tend to dampen investor sentiment.
- ▶ **Consumer prices rose 0.6% in April in Canada** and the year-over-year rate of CPI growth accelerated to 6.8% from 6.7% in March. Food prices jumped again as the economic impacts of the war in Ukraine continued to spill over into Canada. Strong inflationary tailwinds also showed up in core prices, with CPI excluding food and energy rising 0.5% in seasonally adjusted terms. Despite eye-watering price growth, the Bank of Canada poured cold water on anything larger than a 50bp hike at its upcoming rate decision.
- ▶ **Canadian existing homes sales plunged 12.6% in April** on a seasonally adjusted basis, the sharpest month-over-month decline since the start of the pandemic. Nationally, sales were down in 80% of local markets, with most large cities posting double-digit declines in the month. Meanwhile prices for Canadian existing homes fell by 3.8% in April on a seasonally adjusted basis, though they were still up 7.5% over April 2021.
- ▶ **Housing starts increased to an annualized level of 267,330 in April in Canada**, up 8% from March, led by a surge in starts of multi-family units. The April advance in housing starts was concentrated in British Columbia and the Prairie Provinces, as Ontario, Quebec and the Atlantic provinces all saw housing starts retreat in the month.
- ▶ **Manufacturing sales in Canada rose 2.5% m/m in March**, the sixth consecutive monthly increase. Sales volumes were unchanged, indicating that the entire increase in current dollar sales was driven by higher prices.
- ▶ **Wholesale sales edged up 0.3% m/m in March, for the seventh increase in the past eight months**. Sales rose in four of seven subsectors, representing 64% of the total wholesale sector. However, the advance in the month was entirely propped up by higher prices as sales volume fell 0.6% in March.
- ▶ **US retail sales rose 0.9% in April** after surging 1.4% in March (revised up from 0.5%) and 1.7% in February. Based on March and April's solid retail sales reports, second quarter real GDP and real goods spending are looking good.
- ▶ **US industrial production exceeded expectations, rising 1.1% in April** after a 0.9% increase in March. The automotive sector posted a solid 3.9% gain after an 8.3% jump the previous month.
- ▶ **US housing starts slipped 0.2% in April after a 2.8% dip in March**. Despite this drop in new builds, high levels of ongoing construction suggest that residential investment may still contribute to second quarter real GDP.
- ▶ **Sales of existing homes in the US fell for the fourth time in five months** and are down 13.6% from their January peak. The sector remains hampered by limited supply, but we feel that demand is also starting to contract.
- ▶ **Chinese economic news went from bad to worse**. Industrial production fell 2.9% year over year in April and retail sales plummeted 11.1% due to COVID-19 lockdowns. This suggests that Chinese real GDP could fall into the red in the second quarter.
- ▶ **Japanese (non-annualized) real GDP dropped 0.2% in the first quarter**. The Omicron variant took a toll on the economy early in the year, but we expect growth to return in the second quarter.

What to Watch For

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

TUESDAY May 24 - 10:00

April	ann. rate
Consensus	750,000
Desjardins	750,000
March	763,000

WEDNESDAY May 25 - 8:30

April	m/m
Consensus	0.6%
Desjardins	1.5%
March	1.1%

FRIDAY May 27 - 8:30

April	m/m
Consensus	0.6%
Desjardins	0.9%
March	1.1%

THURSDAY May 26 - 8:30

March	m/m
Consensus	n/a
Desjardins	1.5%
February	0.1%

TUESDAY May 24 - 4:00

May	
Consensus	55.0
April	55.8

UNITED STATES

New home sales (April) – Sales of new single-family homes have been slowing for some time now, dropping 12.4% over the first three months of the year. We expect a further decline in April. The number of building permits issued for single-family homes has fallen 7.8% in the last two months. Mortgage applications for home purchases have also dropped to their lowest level since the start of the pandemic. However, builder confidence and sentiment about prospective single-family home purchases remained high in April before falling a bit further in May. We expect sales to dip from 763,000 to 755,000 units.

New durable goods orders (April) – Despite a drop in aircraft orders, new durable goods orders rose nicely in March. We’re forecasting further gains in April, with the aviation sector providing a boost based on orders at Boeing. The automotive sector is projected to expand for the second consecutive month. But based on the decline in the ISM manufacturing index’s “new orders” component, we think orders excluding transportation will fall. Overall, new orders are expected to increase 1.5%, and 0.2% excluding transportation.

Consumer spending (April) – US real GDP contracted in the first quarter, but not because of consumer spending, which rose an annualized 2.7%. Based on April’s 1.0% uptick in retail sales excluding motor vehicles and gasoline, consumer spending has probably made a solid start to the second quarter. New vehicle sales jumped 6.7%. Monthly increases in food services and energy generation also suggest that the service sector is doing well. As such, real consumer spending is expected to rise 0.6% in April. The personal consumption expenditures deflator is also projected to edge up 0.3%. The PCE index is forecast to drop from 6.6% in March—possibly the cyclical peak—to 6.3% in April.

CANADA


Retail sales (March) – Canadian retail sales are expected to increase a solid 1.5% m/m in March, after inching ahead by just 0.1% in February. This is in line with the 1.4% flash estimate for March provided by Statistic Canada with the February release. As in February, higher prices will likely account for most of the increase, with retail sales volumes expected to eke out a modest advance of 0.1% in March. Retail sales excluding motor vehicle and parts dealers are expected to post a strong advance of 3.0% m/m after a respectable print of 2.1% in February. Much like our call for headline retail sales, this is expected to be largely a price story accompanied by a modest advance in sales volumes. At the same time, it also reflects the second consecutive monthly decline in the value of new motor vehicle sales in Canada as unit sales and prices both fell in the month, dragging headline retail sales lower.

OVERSEAS

Eurozone: PMI indexes (May – preliminary) – Despite the risks and challenges facing the European economy, the PMI indexes are holding up rather well. The Eurozone Composite PMI even rose in April to its highest level since September 2021. Businesses in the eurozone have been surprisingly resilient. We’ll see whether this encouraging trend continued in May.


Economic Indicators

Week of May 23 to 27, 2022

Date	Time	Indicator	Period	Consensus		Previous data
UNITED STATES						
MONDAY 23	12:00	Speech of the Federal Reserve Bank of Atlanta President, R. Bostic				
	19:30	Speech of the Federal Reserve Bank of Kansas City President, E. George				
TUESDAY 24	10:00	New home sales (ann. rate)	April	750,000	750,000	763,000
	12:20	Speech of the Federal Reserve Chair, J. Powell				
WEDNESDAY 25	8:30	Durable goods orders (m/m)	April	0.6%	1.5%	1.1%
	12:15	Speech of a Federal Reserve Governor, L. Brainard				
	14:00	Minutes of the Federal Reserve meeting				
THURSDAY 26	8:30	Initial unemployment claims	May 16-20	210,000	205,000	218,000
	8:30	Real GDP (ann. rate)	Q1s	-1.3%	-1.4%	-1.4%
	10:00	Pending home sales (m/m)	April	-1.9%	n/a	-1.2%
FRIDAY 27	8:30	Personal income (m/m)	April	0.5%	0.6%	0.5%
	8:30	Personal consumption expenditures (m/m)	April	0.6%	0.9%	1.1%
	8:30	Personal consumption expenditures deflator				
		Total (m/m)	April	0.2%	0.3%	0.9%
		Excluding food and energy (m/m)	April	0.3%	0.4%	0.3%
		Total (y/y)	April	6.2%	6.3%	6.6%
		Excluding food and energy (y/y)	April	4.9%	5.0%	5.2%
	8:30	Goods trade balance – preliminary (US\$B)	April	-114.8	-111.5	-125.3
	8:30	Retail inventories (m/m)	April	n/a	n/a	2.0%
	8:30	Wholesale inventories – preliminary (m/m)	April	2.0%	n/a	2.3%
10:00	Michigan's consumer sentiment index – final	May	59.1	59.1	59.1	

CANADA

MONDAY 23	---	Markets closed (Victoria Day)				
TUESDAY 24	---	---				
WEDNESDAY 25	---	---				
THURSDAY 26	8:30	Retail sales				
		Total (m/m)	March	n/a	1.5%	0.1%
		Excluding automobiles (m/m)	March	n/a	3.0%	2.1%
FRIDAY 27	---	---				

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 23 to 27, 2022

Country	Time	Indicator	Period	Consensus		Previous data	
				m/m (q/q)	y/y	m/m (q/q)	y/y
OVERSEAS							
MONDAY 23							
Germany	4:00	Ifo survey – Business climate	May	91.4		91.8	
Germany	4:00	Ifo survey – Current situation	May	96.8		97.2	
Germany	4:00	Ifo survey – Expectations	May	86.5		86.7	
Japan	20:30	PMI composite index – preliminary	May	n/a		51.1	
Japan	20:30	PMI manufacturing index – preliminary	May	n/a		53.5	
Japan	20:30	PMI services index – preliminary	May	n/a		50.7	
TUESDAY 24							
France	2:45	Business confidence	May	105		106	
France	2:45	Production outlook	May	-7		-5	
France	3:15	PMI composite index – preliminary	May	57.0		57.6	
France	3:15	PMI manufacturing index – preliminary	May	55.2		55.7	
France	3:15	PMI services index – preliminary	May	58.6		58.9	
Germany	3:30	PMI composite index – preliminary	May	53.8		54.3	
Germany	3:30	PMI manufacturing index – preliminary	May	54.0		54.6	
Germany	3:30	PMI services index – preliminary	May	57.2		57.6	
Euro zone	4:00	PMI composite index – preliminary	May	55.0		55.8	
Euro zone	4:00	PMI manufacturing index – preliminary	May	54.7		55.5	
Euro zone	4:00	PMI services index – preliminary	May	57.5		57.7	
United Kingdom	4:30	PMI composite index – preliminary	May	57.0		58.2	
United Kingdom	4:30	PMI manufacturing index – preliminary	May	55.1		55.8	
United Kingdom	4:30	PMI services index – preliminary	May	57.3		58.9	
New Zealand	22:00	Reserve Bank of New Zealand meeting	May	2.00%		1.50%	
WEDNESDAY 25							
South Korea	---	Bank of Korea meeting	May	1.75%		1.50%	
Japan	1:00	Leading indicator – final	March	n/a		101.0	
Japan	1:00	Coincident indicator – final	March	n/a		97.0	
Germany	2:00	Consumer confidence	June	-25.5		-26.5	
Germany	2:00	Real GDP – final	Q1	0.2%	3.7%	0.2%	3.7%
France	2:45	Consumer confidence	May	89		88	
THURSDAY 26							
Italy	4:00	Consumer confidence	May	99.9		100.0	
Italy	4:00	Economic confidence	May	n/a		105.5	
Japan	19:30	Consumer price index – Tokyo	May		2.5%		2.5%
FRIDAY 27							
Euro zone	4:00	Money supply M3	April		6.3%		6.3%

Note: In contrast to the situation in Canada and the United States, disclosure of overseas economic figures 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).