Economics

THE WEEK AHEAD

February 28-March 4, 2022

North America and the fog of war

by **Avery Shenfeld** avery.shenfeld@cibc.com

Economists are deluged with questions at the most inconvenient times, when uncertainty is at its heights, and precise answers are the least possible. Only days into the outbreak of a tragic war in Europe, potentially the most momentous regional event since the fall of the Berlin wall, there are no easy answers, no button that can be pushed in a forecast model, no way to look at the last five similar events for quantitative guidance. So while we've seen others take global growth down two basis points, or add a point to inflation forecasts, we'll save those sorts of adjustments for when the fog of war has cleared at least a bit.

But there are some broad conclusions that can be gleaned, even at this early stage, in terms of the most likely direction for some of this conflict's impacts. Oil and natural gas prices will retain a risk premium even if Russian exports are not cut off, as will prices for wheat, fertilizers and some metals. Russia will be diminished as a destination for western exports, either due to sanctions or simply a steep drop in the buying power of the ruble. Business confidence will be shaken, particularly on the European continent, and especially in former east bloc countries bordering a less predictable, more imperialist Russia. There are, of course, other risks that we can't judge, including those tied to cyberwarfare, for example.

Clearly, the negative human and economic impacts will be greatest for Ukraine itself, then Russia, followed by eastern and central Europe. In North America, trade and financial links with Russian and Ukraine are much smaller, and much of the impact in North America will come as a biproduct of any slowing in European growth.

Between Canada and the US, the latter is likely more negatively affected. Canada's greater industrial concentration in resources doesn't make it necessarily a net winner, because global growth will still likely be slower, impacting other sectors, but it does leave the economy a bit less vulnerable to this type of global shock. Pay no attention, then, to the quick drop in the loonie on the eve of the invasion, as that was generated by a global flight to the safety of the US greenback, rather than a judgement call on which side of the 49th parallel will be hurt the most economically by the Russian invasion of Ukraine.

While we won't fiddle with our forecast's decimal places just yet, we do need to guide our clients about monetary policy, given that the Bank of Canada has a rate announcement due in the week ahead. Being no better positioned to radically adjust their forecast in these early days of war, the central bankers' views on policy have likely not changed materially.

Indeed, for the Bank of Canada, this isn't even a meeting at which a new forecast is yet due. So the Bank will at most put out some words, rather than numbers, concerning its thinking about this latest shock. Upside risks to inflation in the near term, with some downside risks to growth as an offset, likely still leaves both the Bank of Canada and the Fed on their prior course, with rate hikes on the way this month, and in our view, 100 bps or so for this year as a whole, with more to come in 2023.

What should be off the table, if it ever really was on the table, would be starting that process with a 50-basis point move. Why risk roiling markets that are already pre-roiled by this week's geopolitical news? The market's moves in the past week are unlikely to be the last dose of volatility, given the wide range of possible outcomes for the conflict itself.

As we've argued, rate hikes today are aimed at moderating growth and inflation over the coming four to six quarters. There are plenty of meeting dates ahead in which to accelerate the pace of hikes if need be. Yes, inflation is hot, and likely to get hotter. But that needn't mean that we need to take interest rates though the roof to get enough of an economic slowdown to moderate inflation significantly, or at least the elements of inflation tied to domestic demand.

Week Ahead Calendar And Forecast—Canada

H, M, L = High, Medium or Low Priority
SAAR = Seasonally Adjusted Annual Rate
Consensus Source: Bloomberg

Date	Time	Economic Releases, Auctions and Speakers	Month	Priority	CIBC	Consensus	Prior
Monday, February 28	-	Government Bond Purchase Program (GBPP): 10-YR	-	-	-	-	-
Monday, February 28	-	AUCTION: 10-YR CANADAS $340M	-	-	-	-	-
Monday, February 28	8:30 AM	CURRENT ACCOUNT BAL.	(Q4)	(M)	$2.0B	$2.2B	$1.37B
Monday, February 28	8:30 AM	INDUSTRIAL PROD. PRICES M/M	(Jan)	(M)	-	-	0.7%
Monday, February 28	8:30 AM	RAW MATERIALS M/M	(Jan)	(M)	-	-	-2.9%
Tuesday, March 1	-	Government Bond Purchase Program (GBPP): 5-YR	-	-	-	-	-
Tuesday, March 1	-	AUCTION: 3-M BILLS $8.6B, 6-M BILLS $3.2B, 1-YR BILLS $3.2B	-	-	-	-	-
Tuesday, March 1	8:30 AM	GDP M/M	(Dec)	(H)	-0.2%	0.0%	0.6%
Tuesday, March 1	8:30 AM	GDP (annualized)	(Q4)	(H)	6.3%	6.5%	5.4%
Wednesday, March 2	8:30 AM	ADP EMPLOYMENT CHANGE	-	-	-	-	-
Wednesday, March 2	10:00 AM	BANK OF CANADA RATE ANNOUNCE.	(Mar 2)	(H)	0.50%	0.50%	0.25%
Thursday, March 3	11:30 AM	Speaker: Tiff Macklem (Governor)	-	-	-	-	-
Friday, March 4	-	Government Bond Purchase Program (GBPP): x-YR	-	-	-	-	-
Friday, March 4	8:30 AM	BUILDING PERMITS M/M	(Jan)	(M)	-	-	-1.9%
Friday, March 4	8:30 AM	LABOUR PRODUCTIVITY Q/Q	(Q4)	(M)	-	-	-1.5%
Friday, March 4	10:00 AM	IVEY PMI	(Feb)	(L)	-	-	50.7

Week Ahead Calendar And Forecast—United States

H, M, L = High, Medium or Low Priority
SAAR = Seasonally Adjusted Annual Rate
Consensus Source: Bloomberg

Date	Time	Economic Releases, Auctions and Speakers	Month	Priority	CIBC	Consensus	Prior
Monday, February 28	8:30 AM	ADVANCE GOODS TRADE BALANCE	(Jan)	(M)	-$103B	-$98.5B	-$101B
Monday, February 28	8:30 AM	WHOLESALE INVENTORIES M/M	(Jan P)	(L)	-	-	2.2%
Monday, February 28	8:30 AM	RETAIL INVENTORIES M/M	(Jan)	(H)	-	-	4.4%
Monday, February 28	9:45 AM	CHICAGO PMI	(Feb)	(M)	-	62.0	65.2
Monday, February 28	10:30 AM	Speaker: Raphael W. Bostic (President, Atlanta)	-	-	-	-	-
Tuesday, March 1	9:45 AM	MARKIT US MANUFACTURING PMI	(Feb F)	(L)	-	-	57.5
Tuesday, March 1	10:00 AM	ISM - MANUFACTURING	(Feb)	(H)	58.5	58.0	57.6
Tuesday, March 1	10:00 AM	CONSTRUCTION SPENDING M/M	(Jan)	(M)	-	-0.5%	0.2%
Tuesday, March 1	-	NEW VEHICLE SALES	(Feb)	(M)	-	14.4M	15.04M
Tuesday, March 1	2:00 PM	Speaker: Raphael W. Bostic (President, Atlanta)	-	-	-	-	-
Wednesday, March 2	7:00 AM	MBA-APPLICATIONS	(Feb 25)	(L)	-	-	-13.1%
Wednesday, March 2	8:15 AM	ADP EMPLOYMENT CHANGE	(Feb)	(M)	-	320K	-301K
Wednesday, March 2	2:00 PM	FED'S BEIGE BOOK	-	-	-	-	-
Wednesday, March 2	9:00 AM	Speaker: Charles L. Evans (President, Chicago) (Non-Voter)	-	-	-	-	-
Wednesday, March 2	9:30 AM	Speaker: James Bullard (President, St Louis) (Voter)	-	-	-	-	-
Wednesday, March 2	10:00 AM	Speaker: Jerome H Powell (Chairman) (Voter)	-	-	-	-	-
Wednesday, March 2	4:30 PM	Speaker: Lorie K. Logan (Executive VP, New York)	-	-	-	-	-
Thursday, March 3	8:30 AM	INITIAL CLAIMS	(Feb 26)	(M)	-	-	232K
Thursday, March 3	8:30 AM	CONTINUING CLAIMS	(Feb 19)	(L)	-	-	1476K
Thursday, March 3	8:30 AM	NON-FARM PRODUCTIVITY	(Q4 F)	(M)	-	6.7%	6.6%
Thursday, March 3	9:45 AM	MARKIT US SERVICES PMI	(Feb F)	(L)	-	-	56.7
Thursday, March 3	9:45 AM	MARKIT US COMPOSITE PMI	(Feb F)	(L)	-	-	56.0
Thursday, March 3	10:00 AM	ISM - SERVICES	(Feb)	(M)	62.0	60.9	59.9
Thursday, March 3	10:00 AM	FACTORY ORDERS M/M	(Jan)	(M)	1.5%	0.5%	-0.4%
Friday, March 4	8:30 AM	NON-FARM PAYROLLS	(Feb)	(H)	405K	400K	467K
Friday, March 4	8:30 AM	UNEMPLOYMENT RATE	(Feb)	(H)	3.9%	3.9%	4.0%
Friday, March 4	8:30 AM	AVERAGE HOURLY EARNINGS ALL EMPLOYEES M/M	(Feb)	(H)	0.5%	0.5%	0.7%
Friday, March 4	8:30 AM	AVERAGE WEEKLY HOURS ALL EMPLOYEES	(Feb)	(H)	-	34.6	34.5
Friday, March 4	8:30 AM	MANUFACTURING PAYROLLS	(Feb)	(H)	-	23K	13K

Week Ahead's market call

by Avery Shenfeld

In the **US**, February data are likely to show a healthy pickup in both activity and hiring, with the potential for upside surprises on payrolls and the two ISM indexes. Yet another ugly trade deficit won't do anything to the US dollar immediately, since its trading mostly on the degree of jitters over the Ukraine situation. But it does remind us that the very long term outlook for the greenback has some downside risk given these trade fundamentals.

In **Canada**, a healthy Q4 for real GDP ended on a soft note in December, and with that likely to have carried through into January, sets the stage for a Covid-related soft patch in the overall Q1 pace. But unlike when it met in January, the Bank of Canada can point to a steady taming in hospitalizations and a reopening in services in late February, giving it the green light for what we expect will be a quarter point hike this month, and another in April. The Bank isn't a fan of forward guidance when it's no longer at the lower bound on rates, so the market will be left to its own devices in estimating the precise path ahead. But its language will indicate that it expects a series of rate hikes to provide a braking force on inflation later this year and into 2023, while conceding that in the near term, the CPI will continue to run well about its target.

Week Ahead's key Canadian number: GDP—Q4 and December

(Tuesday, 8:30 am)

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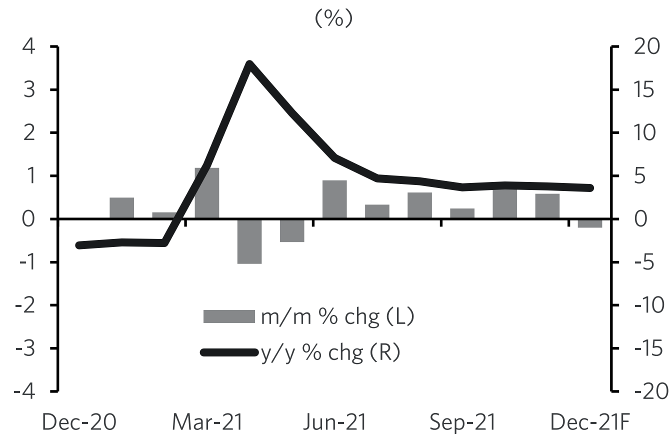
GDP (%)	CIBC	Mkt	Prior
GDP Dec (m/m)	-0.2	0.0	0.6
GDP Q4 (q/q SAAR)	6.3	6.5	5.4

Chart: Canadian real GDP at basic prices



Source: Statistics Canada, Haver Analytics, CIBC

Even though growth was already strong in the third quarter, it appears to have accelerated further in Q4. The 6.3% annualized growth rate would be the quickest of 2021, with residential investment picking back up again, after easing from very high levels during the middle months of the year, and consumer spending likely advancing further as service activities continued to reopen and strengthen throughout much of the quarter. That obviously hit an Omicron wall late in the quarter, as declines in service sector activities in late December are behind our call for a modest 0.2% reduction in GDP for that final month. Looking forward to the early estimate of January GDP, we had been penciling in a further reduction of a ½%, although recent industry data for retail and wholesale sales suggest we might do better than that call.

Judging from positive industry data for manufacturing and wholesale trade during the quarter, we are also likely to see big positive contributions to growth from exports and inventories, linked to some easing in supply chain issues relative to Q3. How much inventory rebuilding contributes to growth in Q4 will give us a sense of how much is still to come throughout the first half of 2022. Personal income and household savings data will also begin to tell us how well aggregate incomes held up following the ending of most pandemic-related support measures mid-quarter.

Forecast implications — While Q4 growth was strong, the weak finish and expected further decline in January will set up only very modest growth during the first quarter of 2022. However, given recent positive industry data for January, and the quick reopening of many service industries in February, there is some upside risk to our current 0.4% growth forecast for that quarter. The Bank of Canada will look through any short-term weakness in December and January monthly GDP, and proceed with its well telegraphed first interest rate hike the day after this GDP data release.

Other Canadian releases: Current account—Q4

(Monday, 8:30 am)

Strong commodity prices contributed to a larger surplus in goods trade during the month, while the slow return of tourist traffic meant that the deficit in services (still modest compared to pre-pandemic norms) was little changed relative to Q3. As such, we expect the current account surplus to have widened to $2.0bn in the fourth quarter, from $1.4bn in the prior quarter.

Week Ahead's key US number: Employment situation—February

(Friday, 8:30 am)

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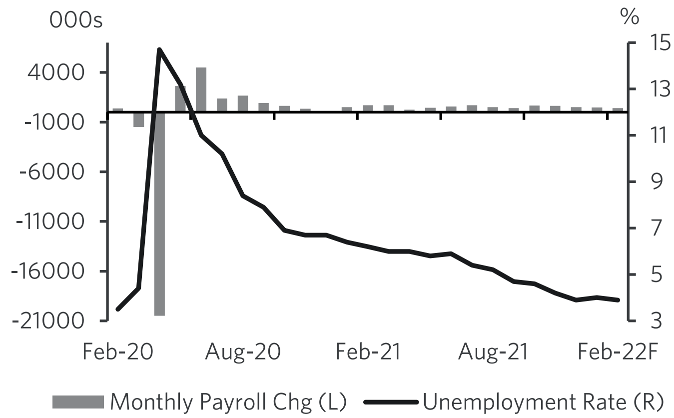
Variable	CIBC	Mkt	Prior
Employment (m/m)	405K	400K	467K
Unemployment rate	3.9%	3.9%	4.0%
Average hourly earnings (m/m)	0.5%	0.5%	0.7%

Chart: US Payroll employment



Source: BLS, Haver Analytics, CIBC

Indicators of activity in service sectors have improved lately and initial jobless claims have eased off since mid-January, suggesting that employers could have added 405K jobs in February. That would reflect hiring in service industries that have been adversely impacted by the pandemic, as the leisure and hospitality sector was still 1.8mn employees short of its pre-pandemic headcount as of January. That gain in jobs could send the unemployment rate down by a tick, to 3.9%, while wage growth was likely strong at 0.5% given the ongoing labor shortage. Most of the impact from Omicron was seen in the decline in hours worked in January, and February should see an improvement on that score as Omicron started to fade.

Forecast implications — With the Omicron wave abating, the US labor market is on track to reach full employment by the summer months as services demand picks up. The minimal impact from Omicron on the economy supports a shorter timeframe for the first doses of Fed hikes, and we now see the Fed hiking rates by 25bps at each of the next four meetings this year before taking a pause to assess their impact over the remaining months in 2022.

Market impact — We are too close to the consensus forecast to expect much market impact.

Other US Releases: Advance international trade in goods—January

(Monday, 8:30 am)

International trade in goods was likely stifled in January as Omicron spread globally, denting demand for US goods abroad. However, the offloading of backlogged containers at US ports as American businesses attempt to restock inventories could have continued to bolster US imports of foreign goods, leaving the goods trade deficit at another record wide level of $103.0bn in January.

ISM Manufacturing—February

(Tuesday, 10:00 am)

Production and new orders were held back by Omicron in the ISM's manufacturing survey in January and should have seen some improvement in February as the virus faded. Tempering those increases on the headline measure could be the fact that reductions in supply chain delays lower the index, which suggests that the total ISM index could have risen only modestly to 58.5 from 57.6 in the prior month.

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