Economics

THE WEEK AHEAD

February 21-25, 2022

Capital spending: The more the merrier?

by Avery Shenfeld avery.shenfeld@cibc.com

The week ahead will see the release of a little-watched but still important data release from Statistics Canada, which reports on the private and public sector's plans for capital spending in the coming year. The topic gained additional prominence after a speech from Bank of Canada Governor Macklem, who drew attention to the need to expand the economy's productive capacity if we're to have a higher ceiling for Canada's non-inflationary output.

But when it comes to capital spending, we'd caution that it's not always a case of the more the merrier, and we perhaps shouldn't be too disappointed if at this stage of the cycle, the cap-ex intentions don't show as much growth as we might be hoping for. For one, remember capital spending is a cost, not an end unto itself. That's obvious at the firm level, where capital projects require taking on more debt, diluting shareholders with new issues, or cutting into potential dividend flows. They therefore need to provide sufficient future returns as an offset. But even for the economy as a whole, funding capital spending entails forgoing some current consumption, or if financed from abroad, increasing liabilities to the rest of the world.

One reason capital spending isn't living up to its former glory is that economic growth is no longer as dependent upon it. Changes in the sectoral composition of the economy have increased output in knowledge based and services industries, and decreased the share of heavy industry that requires massive capital projects. Output gains in knowledge-based sectors are much more dependent on human capital, on whether we are educating and training our own population, or drawing in immigrants with the required skill set.

As well, the computing and communications equipment needed in sectors like finance, e-commerce and software has fallen so dramatically in terms of its costs that smaller nominal levels of spending entail massive improvements in productivity and capacity relative to decades gone by. As they say, your smart phone has vastly more computing power than NASA's 1969 Apollo spacecraft.

The trend growth rate needed to stay at full employment is also slower than in prior decades, due to softer growth in our working age population. That reduces the need for capacity additions across a range of domestically focused industries.

And on that score, we're at a stage of the business cycle where there's still ample excess capacity in the sectors most likely to generate growth in the year or two ahead. We don't really need a lot of new movie theatres, hotels, office towers, restaurants, stores, aircraft, concert halls, and convention centres for a more complete recovery in the services activities that have been held back during the pandemic. Growth in these sectors will therefore not raise as much inflation concern at the Bank of Canada even if their capital spending is weak.

So at a minimum, we should focus our attention not on total capital spending intentions, but on those for sectors that are closer to their capacity limits, or in export-oriented industries that will benefit from a global expansion ahead.

In the end, our growth prospects will depend as much on what kinds of capital spending we undertake as on their total dollar value. Climate change issues will have the private sector working on reducing carbon emissions per unit of production to give them the green light to expand output. The power sector could face needs to add to our capacity to generate clean electric energy. In manufacturing, rising labour costs, and the need to build in supply chain resiliency, could warrant a greater focus on automation and facilities needed to expand inventories. And we shouldn't forget public infrastructure, particularly that aimed at adding resiliency and capacity in health care to address the gaps that the pandemic has highlighted.

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 21	-	Markets Closed (Family Day: Alberta, British Columbia, Nova Scotia and Ontario)	-	-	-	-	-
Tuesday, February 22	-	BRITISH COLUMBIA BUDGET	-	-	-	-	-
Wednesday, February 23	-	Government Bond Purchase Program (GBPP): 5-YR	-	-	-	-	-
Thursday, February 24	-	Government Bond Purchase Program (GBPP): 30-YR	-	-	-	-	-
Thursday, February 24	-	AUCTION: 30-YR CANADAS $135M	-	-	-	-	-
Thursday, February 24	8:30 AM	PAYROLL EMPLOYMENT, EARNINGS & HRS	(Dec)	-	-	-	-
Thursday, February 24	-	ALBERTA BUDGET	-	-	-	-	-
Friday, February 25	8:30 AM	Non-residential capital and repair expenditures, 2020 (revised), 2021 (preliminary) and 2022 (intentions)	-	-	-	-	-

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 21	-	Markets Closed (President's Day)	-	-	-	-	-
Monday, February 21	11:15 AM	Speaker: Michelle W Bowman (Governor) (Voter)	-	-	-	-	-
Tuesday, February 22	-	AUCTION: 1-YR TREASURIES $34B	-	-	-	-	-
Tuesday, February 22	-	AUCTION: 2-YR TREASURIES $52B	-	-	-	-	-
Tuesday, February 22	9:00 AM	HOUSE PRICE INDEX M/M	(Dec)	(M)	-	1.1%	1.1%
Tuesday, February 22	9:00 AM	S&P CORELOGIC CS Y/Y	(Dec)	(H)	-	18.3%	18.3%
Tuesday, February 22	9:45 AM	MARKIT US SERVICES PMI	(Feb P)	(L)	-	53.0	51.2
Tuesday, February 22	9:45 AM	MARKIT US COMPOSITE PMI	(Feb P)	(L)	-	-	51.1
Tuesday, February 22	9:45 AM	MARKIT US MANUFACTURING PMI	(Feb P)	(L)	-	56.0	55.5
Tuesday, February 22	10:00 AM	CONF.BOARD CONSUMER CONFIDENCE	(Feb)	(H)	109.0	110.0	113.8
Tuesday, February 22	10:00 AM	RICHMOND FED MANUF. INDEX	(Feb)	(M)	-	10	8
Tuesday, February 22	3:30 PM	Speaker: Raphael W. Bostic (President, Atlanta)	-	-	-	-	-
Wednesday, February 23	-	AUCTION: 2-YR FRN $22B	-	-	-	-	-
Wednesday, February 23	-	AUCTION: 5-YR TREASURIES $53B	-	-	-	-	-
Wednesday, February 23	7:00 AM	MBA-APPLICATIONS	(Feb 18)	(L)	-	-	-5.4%
Thursday, February 24	-	AUCTION: 7-YR TREASURIES $50B	-	-	-	-	-
Thursday, February 24	8:30 AM	INITIAL CLAIMS	(Feb 19)	(M)	-	238K	248K
Thursday, February 24	8:30 AM	CONTINUING CLAIMS	(Feb 12)	(L)	-	-	1593K
Thursday, February 24	8:30 AM	CHICAGO FED NAT.ACTIVITY INDEX	(Jan)	(M)	-	-	-0.15
Thursday, February 24	8:30 AM	GDP (annualized)	(4Q S)	(H)	6.9%	7.0%	6.9%
Thursday, February 24	8:30 AM	GDP DEFLATOR (annualized)	(4Q S)	(H)	-	6.9%	6.9%
Thursday, February 24	10:00 AM	NEW HOME SALES SAAR	(Jan)	(M)	795K	809K	811K
Thursday, February 24	10:00 AM	NEW HOME SALES M/M	(Jan)	(M)	-2.0%	-0.3%	11.9%
Thursday, February 24	9:00 AM	Speaker: Thomas I. Barkin (President, Richmond)	-	-	-	-	-
Thursday, February 24	11:10 AM	Speaker: Raphael W. Bostic (President, Atlanta)	-	-	-	-	-
Thursday, February 24	12:00 PM	Speaker: Loretta Mester (President, Cleveland) (Voter)	-	-	-	-	-
Thursday, February 24	8:00 PM	Speaker: Christopher J. Waller (Governor) (Voter)	-	-	-	-	-
Friday, February 25	8:30 AM	PCE DEFLATOR Y/Y	(Jan)	(H)	6.1%	6.0%	5.8%
Friday, February 25	8:30 AM	PCE DEFLATOR Y/Y (core)	(Jan)	(H)	5.2%	5.2%	4.9%
Friday, February 25	8:30 AM	PERSONAL INCOME M/M	(Jan)	(H)	-0.5%	-0.3%	0.3%
Friday, February 25	8:30 AM	PERSONAL SPENDING M/M	(Jan)	(H)	1.6%	1.5%	-0.6%
Friday, February 25	8:30 AM	DURABLE GOODS ORDERS M/M	(Jan P)	(H)	0.7%	0.6%	-0.7%
Friday, February 25	8:30 AM	DURABLE GOODS ORDERS EX-TRANS M/M	(Jan P)	(H)	0.4%	0.3%	0.6%
Friday, February 25	10:00 AM	PENDING HOME SALES M/M	(Jan)	(M)	-	-	-3.8%
Friday, February 25	10:00 AM	MICHIGAN CONSUMER SENTIMENT	(Feb F)	(H)	-	61.7	61.7

Week Ahead's market call

by Avery Shenfeld

In the **US**, a holiday shortened week should feature healthy gains for durable orders and consumer spending in January, the latter lifted by a sharp jump in auto sales and higher prices. Despite all that shopping, consumer confidence likely slipped in the latest reading, hit by inflation concerns. A number of Fed speakers will also weigh in. But eyes will also be on the Russia-Ukraine border, with developments there influencing markets on a day-to-day basis.

In **Canada**, the two most westerly provinces kick off the budget season, one in which upside revenue surprises in the outgoing year will have given governments a much better starting point for the current year. We've noted, however, that given the economic progress already in the rear view mirror, a similar surprise is now much less likely for the year ahead, so provincial bond investors won't be able to count on the same sort of good news lift during fiscal 2022-23. Also on our calendar, although it's never a market mover, is Friday's release of the survey of non-residential capital spending intentions for 2022, which many economists use to refine forecasts for investment spending.

There are no major Canadian data releases next week.

Week Ahead's key US number: Personal income and outlays—January

(Friday, 8:30 am)

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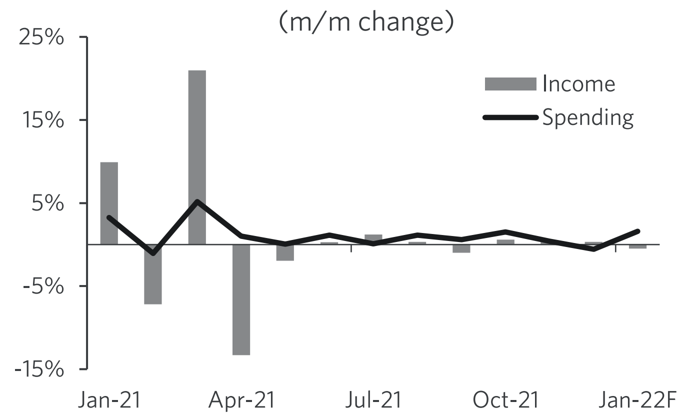
Personal income and outlays (%)	CIBC	Mkt	Prior
Personal income (m/m)	-0.5	-0.3	0.3
Personal spending (m/m)	1.6	1.5	0.6
Core PCE price index (y/y)	5.2	5.2	4.9

Chart: US Personal income and spending (m/m change)



Source: BEA, Haver Analytics, CIBC

January was an explosive month for spending on goods as vehicle sales jumped and spending shifted online as Omicron spread, showing that consumers haven't been materially deterred by higher prices. The weakness expected in services spending resulting from Omicron in January will be more than offset by the surge in spending on goods, likely leaving total spending 1.6% higher on the month. That would have required some drawdown of savings, as incomes likely fell by 0.5% due to expiring child tax credit payments.

Total PCE price inflation likely accelerated to 6.1% y/y, and core PCE prices could have reached 5.2% y/y.

Forecast implications — The pick up in spending in January shows that the US economy has been more resilient than expected during Omicron. Accelerating prices will erase a large portion of the nominal spending gain in volume terms, while still providing a reason for the Fed to fast track its hiking cycle.

Market impact — We are close enough to consensus to imply little market impact if our calls are on the mark.

Other US Releases: Durable goods orders—January

(Friday, 8:30 am)

Commercial aircraft orders are poised to show a rebound in January, supporting a 0.7% advance in total durable goods orders. Excluding the volatile transportation component, orders likely increased by a moderate 0.4% as capacity utilization in the industrial sector climbed further above its pre-pandemic level in January, and the shift towards automation in production amidst the worker shortage continued.

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