Economics

THE WEEK AHEAD

May 2-6, 2022

Powell's tricky task

by Avery Shenfeld avery.shenfeld@cibc.com

The market seemed as puzzled as we were on the release of US Q1 GDP data. It's hard to explain a steep drop in goods output in a quarter in which factory hours and the Fed's index of industrial production registered healthy gains. The overall gain in hours worked in the quarter implies a horrendously large drop in productivity. Perhaps with so many distortions arising from Covid in the last few years, both the seasonal adjustment processes for these various series, and even the raw data for any one quarter, aren't useful guideposts.

Given that volatility, one quarter of real GDP decline doesn't alter the Fed's task much. Their eyes are fixed on inflation, and particularly an important domestic driver, labour markets. And Powell's latest musings on that subject underscore just how tricky their task is.

Some are pointing to the fact that the Fed has never achieved as sharp a deceleration in inflation as it aims to engender without causing a recession. That's actually not our central worry, because we haven't really faced this type of inflation in the past. Earlier episodes, such as that of the early 1980s, were the culmination of longer climbs that had ingrained soaring prices and wages as the norm. This bout of inflation came in one sudden push, after decades of tame prices that are still seen in expectations as likely to return.

Moreover, war- and Covid-related disruptions to production, should they abate next year, could see prices for items like new and used vehicles and oil actually tumble sharply by 2023, or at least stop climbing. So a lot of the Fed's job on inflation could happen on its own accord.

The problem is that just as this year's spikes in such prices have made the inflation problem look worse, next year's retreats will have the CPI understating the true trend. Getting inflation down will be easier than keeping it that way, unless we slow the pace of hiring and prevent a further tightening in the labour market. Indeed, Powell has conceded that the job market is "unsustainably hot."

That's where we'll need some exceptional skill from the Fed, because it will have to achieve a different feat for the first time: keep the economy growing in 2023/24, but at a pace just low enough to leave the jobless rate where it currently sits, at 3.6%, in 2024. That's the consensus forecast from the FOMC, and presumably that aligns with their views on what's needed to sustain 2% inflation.

And there's the rub. The Fed has never steered the US economy so that it hugs a cyclical low in unemployment rate for that length of time. There are no long bottoms for the jobless rate on record (Chart). That's not to say it's impossible, because there's a growth rate above zero, likely in the vicinity of 2%, that would do just that. But like landing a fighter jet on the deck of an aircraft carrier, the margin of error is tight.

There's still reason to hope that it's doable, because lower inflation late this year or in early 2023 will give the green light for the Fed to slow the pace of rate hikes. Pilots landing on aircraft carriers don't come in a full speed, and that's what the Fed will need to do to hit its mark after zooming ahead on rate hikes in 2022.

Chart: No long bottoms in US jobless rate

Source: BLS, FOMC

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, May 2	-	AUCTION: 10-YR CANADAS $4B	-	-	-	-	-
Tuesday, May 3	12:45 PM	Speaker: Carolyn Rogers (Sr. Deputy Gov.)	-	-	-	-	-
Wednesday, May 4	8:30 AM	MERCHANDISE TRADE BALANCE	(Mar)	(H)	$3.8B	-	$2.66B
Thursday, May 5	9:55 AM	Speaker: Lawrence Schembri (Deputy Gov.)	-	-	-	-	-
Friday, May 6	8:30 AM	EMPLOYMENT CHANGE	(Apr)	(H)	55.0K	-	72.5K
Friday, May 6	8:30 AM	UNEMPLOYMENT RATE	(Apr)	(H)	5.2%	-	5.3%
Friday, May 6	10:00 AM	IVEY PMI	(Apr)	(L)	-	-	74.2

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, May 2	10:00 AM	ISM - MANUFACTURING	(Apr)	(H)	58.2	57.8	57.1
Monday, May 2	10:00 AM	CONSTRUCTION SPENDING M/M	(Mar)	(M)	-	0.8%	0.5%
Tuesday, May 3	10:00 AM	FACTORY ORDERS M/M	(Mar)	(M)	1.7%	1.0%	-0.50%
Tuesday, May 3	10:00 AM	JOLTS Job Openings	(Mar)	-	-	-	-
Tuesday, May 3	-	NEW VEHICLE SALES	(Apr)	(M)	-	13.80M	13.33M
Wednesday, May 4	7:00 AM	MBA-APPLICATIONS	(Apr 29)	(L)	-	-	-8.3%
Wednesday, May 4	8:15 AM	ADP EMPLOYMENT CHANGE	(Apr)	(M)	-	388K	455K
Wednesday, May 4	8:30 AM	GOODS & SERVICES TRADE BALANCE	(Mar)	(H)	-$107.9B	-$97.0B	-$89.2B
Wednesday, May 4	10:00 AM	ISM - SERVICES	(Apr)	(M)	58.6	58.7	58.3
Wednesday, May 4	2:00 PM	FOMC RATE DECISION (UPPER BOUND)	(May 4)	(H)	1.00%	1.00%	0.50%
Wednesday, May 4	2:00 PM	FOMC RATE DECISION (LOWER BOUND)	(May 4)	(H)	0.75%	0.75%	0.25%
Wednesday, May 4	2:30 PM	Speaker: Jerome H Powell (Chairman) (Voter)	-	-	-	-	-
Thursday, May 5	8:30 AM	INITIAL CLAIMS	(Apr 30)	(M)	-	183K	180K
Thursday, May 5	8:30 AM	CONTINUING CLAIMS	(Apr 23)	(L)	-	-	1408K
Thursday, May 5	8:30 AM	NON-FARM PRODUCTIVITY	(Q1 P)	(M)	-5.8%	-2.8%	6.6%
Friday, May 6	8:30 AM	NON-FARM PAYROLLS	(Apr)	(H)	315K	390K	431K
Friday, May 6	8:30 AM	UNEMPLOYMENT RATE	(Apr)	(H)	3.5%	3.6%	3.6%
Friday, May 6	8:30 AM	AVERAGE HOURLY EARNINGS ALL EMPLOYEES M/M	(Apr)	(H)	0.4%	0.4%	0.4%
Friday, May 6	8:30 AM	AVERAGE WEEKLY HOURS ALL EMPLOYEES	(Apr)	(H)	-	34.7	34.6
Friday, May 6	8:30 AM	MANUFACTURING PAYROLLS	(Apr)	(H)	-	-	38K
Friday, May 6	3:00 PM	CONSUMER CREDIT	(Apr)	(L)	-	$25.00B	$41.82B
Friday, May 6	9:15 AM	Speaker: John C. Williams (Vice Chairman, New York) (Voter)	-	-	-	-	-
Friday, May 6	3:00 PM	Speaker: Raphael W. Bostic (President, Atlanta)	-	-	-	-	-
Friday, May 6	7:15 PM	Speaker: James Bullard (President, St Louis) (Voter), Christopher J. Waller (Governor) (Voter)	-	-	-	-	-
Friday, May 6	8:00 PM	Speaker: Mary C. Daly (President, San Francisco)	-	-	-	-	-

Week Ahead's market call

by Avery Shenfeld

In the **US**, while there are no sure things in economics or sports, a 50 basis point rate hike from the Fed seems to be a lock at this point, with the accompanying statement brushing aside the first quarter GDP decline. On the data front, either the lack of people to hire, or the reduced need to do so given softer output, could see payrolls gains fall short of consensus expectations, but still be firm enough to drop the jobless rate by one tick. Q1 productivity will be abysmal, given the mismatch between a drop in non-farm business output in Q1 and a gain in hours worked. Although the goods sector was central to the Q1 GDP drop, we expect healthy readings on factory orders and the ISM.

In **Canada**, we're at the stage in which good news can be bad news for financial markets, given that the greatest fear is now an inflationary overheating. So another strong employment gain could add to that concern, with Friday's data likely to push the jobless rate still lower. Our research identified that there is still some elbow room for non-inflationary job gains in some provinces, so the inflation consequences depend on where we're seeing the hiring. The March trade balance will gain support from elevated commodity prices.

Week Ahead's key Canadian number: Labour force survey—April

(Friday, 8:30 am)

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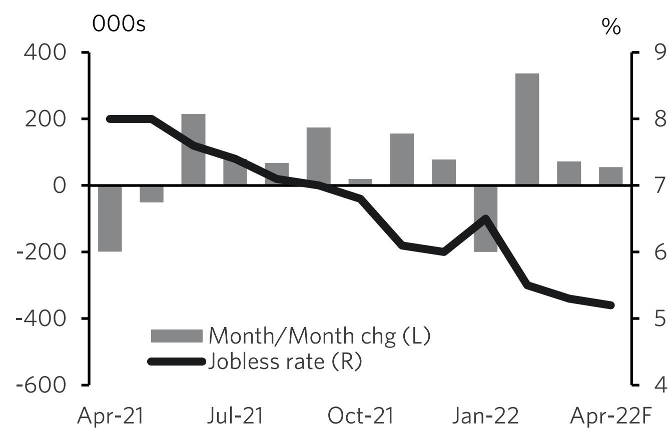
Labour force survey	CIBC	Mkt	Prior
Employment (m/m)	55.0K	-	72.5K
Unemployment rate	5.2%	-	5.3%

Chart: Canadian employment



Source: Statistics Canada, Haver Analytics, CIBC

A continued strengthening of demand for consumer facing services likely resulted in increased efforts among companies to fill vacant positions in April. The result could be a further solid increase in overall employment levels (we forecast +55K), led by labour intensive services such as food & accommodation. However, those efforts to fill vacancies likely included higher wages, putting upward pressure on hourly earnings, as will cost of living adjustments stemming from the current high inflation environment.

The gain expected in total employment should be good enough to edge the jobless rate down to 5.2%. While that would be another record low, further modest declines could still be seen before the labour market becomes tight enough to drive sustained , strong, wage pressure. A smaller proportion of seasonal jobs in today's labour market means that short-term, frictional, unemployment is lower, which impacts the overall jobless rate. Moreover, those areas of the country that were clearly not at full employment pre-pandemic, such as Alberta and Saskatchewan, should be able to reach unemployment rates well below their February 2020 levels.

Forecast implications — The Canadian labour market is tight, but not necessarily overheated in most areas of the country. The jobless rate could dip further before mid-year, but a slowing in economic growth as interest rate hikes take hold could see it move back up towards 5½% by year-end.

Other Canadian releases: Merchandise trade—March

(Wednesday, 8:30 am)

Almost everything likely went in favour of a larger Canadian trade balance in March. Surging commodity prices, particularly oil, likely helped nominal exports. Meanwhile the ending of bridge blockades that impacted February's figures likely supported a gain in two-way trade. Judging by the US's advance trade data, Canadian exports for autos in particular may have gained more than imports. Add that up and the trade surplus may have widened by more than $1bn to $3.8bn in March, from $2.7bn in the prior month.

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

(Friday, 8:30 am)

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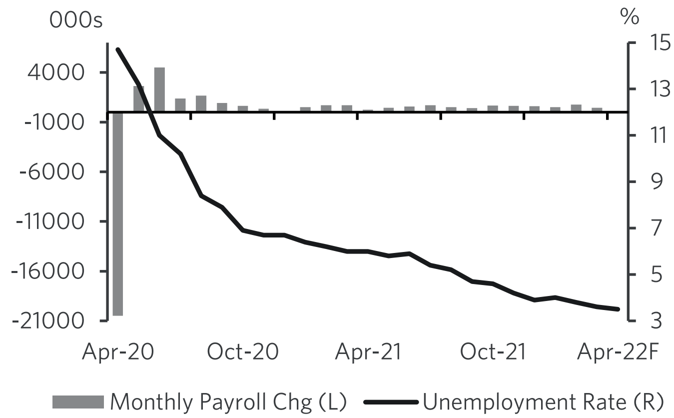
Variable	CIBC	Mkt	Prior
Employment (m/m)	315K	390K	431K
Unemployment rate	3.5%	3.6%	3.6%
Avg hourly earnings (m/m)	0.4%	0.4%	0.4%

Chart: US payroll employment



Source: BLS, Haver Analytics, CIBC

Although job openings remain at lofty levels in the US, with the prime-age employment-to-population ratio only slightly below its pre-pandemic level, hiring likely slowed to 315K in April as the labor supply pool remains slim. Moreover, high-frequency indicators of activity in service sectors levelled off during the month as the Omicron subvariant spread, and the downside surprise in the Q1 GDP report could also portend a bit less vigorous hiring in goods sectors.

Higher wages were likely still on offer as employers tried to overcome the labor shortage in some industries, with average hourly wages expected to show 0.4% growth on the month. The unemployment rate likely fell to 3.5%, its pre-pandemic level, on the still healthy employment gain.

Forecast implications — The tightness in the labor market continues to stoke inflation fears as wages rise, something that the Fed is set to lean against with a series of 50bps hikes over its next three FOMC meetings.

Market impact — We're below the consensus which could see the USD and bond yields fall.

Other US Releases: ISM Manufacturing—April

(Monday, 10:00 am)

The ISM's manufacturing index likely rose to 58.2 in April, but that would include a lift from renewed supply chain disruptions stemming from the lockdowns in China, which simultaneously could have limited production growth. The new orders sub-index could have risen as businesses continue to look to rebuild inventories and hedge against future supply chain disruptions by holding greater stockpiles of goods.

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