Economics

THE WEEK AHEAD

March 13-17, 2023

The carrot and the stick

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

In the pristine world of textbook economics, subsidizing selected industrial activities is deemed to be an undesirable diversion from the free market's invisible hand. But in the messy world of actual economies, things aren't quite so simple, as Canada's upcoming federal budget is likely to underscore.

Economists long ago recognized that "externalities" — negative impacts like climate change not borne by those creating them — create a case for intervening in markets, with theory pointing to taxes on such activities as a way of making economic actors take those costs into account. Canada's initial approach to climate change included carbon taxes as a way of incenting business and consumers to favour untaxed zero-emission alternatives.

South of our border, taxing fossil fuels and other carbon sources was a political non-starter. Americans have always taxed gasoline at much lower rates than Canada or Europe. A supposedly eco-conscious Biden administration ordered a release of oil reserves in order to lower the cost of gasoline prior to the mid-term elections. Cheap gasoline is seen as American as apple pie, and a single Senator from a coal producing state can be an impediment to greening the power sector if it entails penalizing that fuel.

So to move the needle on the climate change file, the Biden administration moved away from the stick towards the carrot, and found enough votes in Congress for subsidizing a greening of the US economy in its roughly $400 bn Inflation Reduction Act, and threw in additional funds to subsidize $350 bn in loans for energy projects.

And that creates a headache for competing jurisdictions, which risk seeing US industry gain an upper hand in what could be a major slice of economic activity in the decade ahead. Trade agreements might let Canada counter subsidies with tariffs on US exports, but setting off a trade war isn't a step taken lightly. A tit-for-tat introduction of trade barriers isn't going to be a winner for an export-oriented Canadian economy.

So Ottawa has already signaled that the scale of US subsidies will require a response in the upcoming federal budget. While governments had already been developing policies to support carbon capture in the oil and gas sector, and to help workers transition to green industry employment, Canada will now dangle additional carrots in front of its business sector as a way of levelling the playing field for activities that could take place on either side of the border. The dollars being thrown around stateside might be difficult to match, so we'll need a program that focusses in on areas where Canada can compete, and where US subsidies would have a material impact on location decisions and relative business costs.

From a fiscal perspective, there are ways of reducing the potential hit to budget balances. With more money also being allocated for health transfers, and new initiatives likely to mean at least a temporary upturn in the debt/GDP ratio as the economy slows this year, it might also be opportune to initiate a broader review of federal programs to identify areas of government spending that have become less of a priority. Some of the funding for green-sector subsidies could come from dollars that prior budgets have already set aside for economic growth initiatives.

But we also need to ensure that where we hand out carrots, we actually feed economic growth. To stick with the food analogy, those of us with long memories of government business handouts might recall, for example, the heavily-subsidized Sprung greenhouse, which failed to grow vegetables. We'll need to make sure that the private sector has enough skin in the game so that projects sponsored under whatever initiative the budget offers stick around long enough to deliver lasting jobs and environmental benefits.

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, March 13	-	-	-	-	-	-	-
Tuesday, March 14	-	AUCTION: 3-M BILLS $10.4, 6-M BILLS $3.8B, 1-YR BILLS $3.8B	-	-	-	-	-
Tuesday, March 14	8:30 AM	MANUFACTURING SHIPMENTS M/M	(Jan)	(M)	4.0%	-	-1.5%
Wednesday, March 15	-	AUCTION: 10-YR CANADAS $8B	-	-	-	-	-
Wednesday, March 15	8:15 AM	HOUSING STARTS SAAR	(Feb)	(M)	220K	-	215.4K
Wednesday, March 15	9:00 AM	EXISTING HOME SALES M/M	(Feb)	(M)	-	-	-3.0%
Thursday, March 16	-	AUCTION: 2-YR CANADAS $7B	-	-	-	-	-
Thursday, March 16	8:30 AM	WHOLESALE TRADE M/M	(Jan)	(M)	-	-	-
Friday, March 17	8:30 AM	INT'L. SEC. TRANSACTIONS	(Jan)	(M)	-	-	$21.2B
Friday, March 17	8:30 AM	INDUSTRIAL PROD. PRICES M/M	(Feb)	(M)	-	-	0.4%
Friday, March 17	8:30 AM	RAW MATERIALS M/M	(Feb)	(M)	-	-	-0.1%

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, March 13	-	-	-	-	-	-	-
Tuesday, March 14	8:30 AM	CPI M/M	(Feb)	(H)	0.4%	0.4%	0.5%
Tuesday, March 14	8:30 AM	CPI M/M (core)	(Feb)	(H)	0.4%	0.4%	0.4%
Tuesday, March 14	8:30 AM	CPI Y/Y	(Feb)	(H)	6.1%	6.0%	6.4%
Tuesday, March 14	8:30 AM	CPI Y/Y (core)	(Feb)	(H)	5.5%	5.5%	5.6%
Tuesday, March 14	5:20 PM	Speaker: Michelle W Bowman (Governor) (Voter)	-	-	-	-	-
Wednesday, March 15	7:00 AM	MBA-APPLICATIONS	(Mar 10)	(L)	-	-	7.4%
Wednesday, March 15	8:30 AM	PPI M/M	(Feb)	(M)	0.3%	0.3%	0.7%
Wednesday, March 15	8:30 AM	PPI M/M (core)	(Feb)	(M)	0.4%	0.4%	0.5%
Wednesday, March 15	8:30 AM	PPI Y/Y	(Feb)	(M)	-	5.4%	6.0%
Wednesday, March 15	8:30 AM	PPI Y/Y (core)	(Feb)	(M)	-	5.2%	5.4%
Wednesday, March 15	8:30 AM	NEW YORK FED (EMPIRE)	(Mar)	(M)	-	-7.7	-5.8
Wednesday, March 15	8:30 AM	RETAIL SALES M/M	(Feb)	(H)	0.0%	0.2%	3.0%
Wednesday, March 15	8:30 AM	RETAIL SALES (X-AUTOS) M/M	(Feb)	(H)	0.2%	-0.1%	2.3%
Wednesday, March 15	8:30 AM	RETAIL SALES CONTROL GROUP M/M	(Feb)	(H)	-0.5%	-0.3%	1.7%
Wednesday, March 15	10:00 AM	BUSINESS INVENTORIES M/M	(Jan)	(L)	-	0.0%	0.3%
Wednesday, March 15	10:00 AM	NAHB HOUSING INDEX	(Mar)	(L)	-	41	42
Wednesday, March 15	4:00 PM	NET CAPITAL INFLOWS (TICS)	(Jan)	(L)	-	-	$152.8B
Thursday, March 16	8:30 AM	INITIAL CLAIMS	(Mar 11)	(M)	-	-	211K
Thursday, March 16	8:30 AM	CONTINUING CLAIMS	(Mar 4)	(L)	-	-	1718K
Thursday, March 16	8:30 AM	IMPORT PRICE INDEX M/M	(Feb)	(L)	-	-0.2%	-0.2%
Thursday, March 16	8:30 AM	EXPORT PRICE INDEX M/M	(Feb)	(L)	-	-0.3%	0.8%
Thursday, March 16	8:30 AM	HOUSING STARTS SAAR	(Feb)	(M)	1320K	1310K	1309K
Thursday, March 16	8:30 AM	BUILDING PERMITS SAAR	(Feb)	(H)	1340K	1350K	1339K
Thursday, March 16	8:30 AM	PHILADELPHIA FED	(Mar)	(M)	-	-14.8	-24.3
Friday, March 17	9:15 AM	INDUSTRIAL PRODUCTION M/M	(Feb)	(H)	0.1%	0.5%	0.0%
Friday, March 17	9:15 AM	CAPACITY UTILIZATION	(Feb)	(M)	78.4%	78.5%	78.3%
Friday, March 17	10:00 AM	LEADING INDICATORS M/M	(Feb)	(M)	-	-0.2%	-0.3%
Friday, March 17	10:00 AM	MICHIGAN CONSUMER SENTIMENT	(Mar P)	(H)	-	67	67

Week Ahead's market call

by Avery Shenfeld

In the **US**, the payrolls data were enough of a mixed bag that the Fed's 25 or 50 decision likely comes down to what the CPI has to say. Our call is on consensus, and while a 0.4% core increase isn't anything to cheer about, it would probably be enough to have the Fed stick with 25 bp hikes, given other concerns emerging in the banking system of late. We're also a bit below consensus in our call for the control group of retail sales, which would again lean the same way. Reports on housing, industrial production, producer prices and consumer confidence will round out a jam packed week for economic news stateside.

In **Canada**, by contrast, the economic cupboard is a bit bare in terms of new data in the week ahead. Manufacturing shipments looked to have posted a solid gain to start the year, while we expect housing starts to hold relatively steady. The tone in the bond and FX markets is more likely to be steered by the news from the US, particularly since some of the discussion on whether the Bank of Canada will or won't hike again in 2023 rests on how aggressive markets think the Fed will have to get.

There are no major Canadian data releases next week.

Week Ahead's key US number: Consumer price index—February

(Tuesday, 8:30 am)

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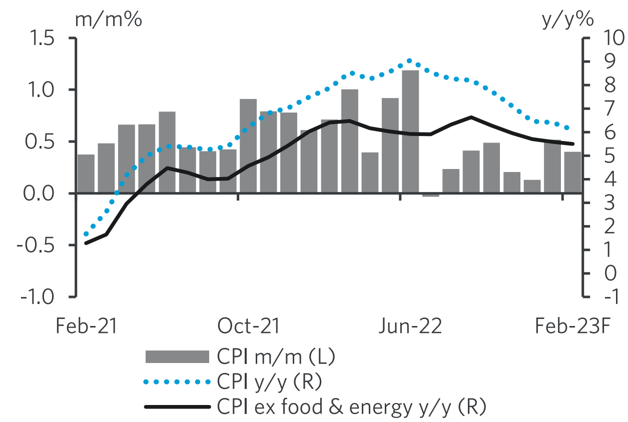
Variable (%)	CIBC	Mkt	Prior
Headline CPI m/m	0.4	0.4	0.5
Headline CPI (y/y)	6.1	6.0	6.4
Core CPI m/m	0.4	0.4	0.4
Core CPI y/y	5.5	5.5	5.6

Chart: US consumer price index



Source: BLS, Haver Analytics, CIBC

A further increase in prices at the pump and continued pressure in core categories suggest that prices rose by an uncomfortably fast 0.4% in February. Looking at core (ex. food and energy) categories, shelter prices are set to peak imminently as the typical lags with new leases that are resetting at lower rates kick in, but continued pressure in core services outside of shelter, in line with the tight labor market, will keep the Fed on a tightening path. Moreover, the deflation in core goods prices appears to have ended, as supply chains have normalized, and used car prices as measured by industry gauges climbed in February.

Forecast implications — A consensus-matching core CPI reading will likely be good enough to keep the Fed on track for a 25 bp hike this month. With housing inflation set to peak soon, and a deterioration in the labor market more likely ahead as previously announced layoffs come to fruition and the impact of past rate hikes materializes more fully, core inflation is set to decelerate to 2½ % by the end of the year.

Market impact — We're in line with the consensus expectation, which should limit market reaction.

Other US Releases: Retail sales—February

(Wednesday, 8:30 am)

January's surge in auto sales looks to have reversed in February, but an increase in restaurant reservations and higher gasoline prices could have offset that to result in flat retail sales in February. The control group of sales (ex. autos, restaurants, gasoline, and building materials), which feeds more directly into non-auto goods consumption in GDP, likely saw sales fall by 0.5% following a lofty increase in January that seemed to be biased up by seasonal factors. Moreover, services could have garnered more funds than control group categories in February, given the higher pace of inflation in those sectors.

Industrial production—February

(Friday, 9:15 am)

Continued improvement in supply chains didn't prevent a drop in manufacturing payrolls and hours worked in February. Combined with a drop in rig counts and hours worked in mining, total industrial production likely eked out an only 0.1% gain on higher utilities output. And the outlook for production ahead doesn't look any better, given the cyclical slowdown in factory orders that's underway.

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