CIBC Economics

THE WEEK AHEAD

March 4 - 8, 2024

Why Finance Ministers are still sweating it

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

Ordinarily, a Canadian federal or provincial finance minister wouldn't be sweating about their budgets when the country's jobless rate sits at only 5.7%. You have to go back to 1974 to find a year in which the average unemployment was any lower. So why will this year still see many finance ministers struggling to contain deficits and borrowing needs?

In part, it reflects a less impressive employment rate, with an aging population leading to fewer tax payers. Yours truly also bears part of the blame, as I participate in surveys of private sector forecasts that Ottawa and many provinces use in their fiscal plans. Sluggish growth forecasts will feed into soft revenue projections. But there are less obvious factors making for a challenging budget season.

For one, inflation, has turned into the finance minister's enemy rather than friend. Back in 2022, inflation had been a winner, boosting nominal revenues from sources like sales taxes or resource royalties. But as of 2023, it's turned into more of a negative, with inflation hitting government operating expenditures more than it's lifting nominal GDP, given the gap between the deflators on those two elements of the national accounts (Chart). Much of that reflects catch-up wage increases granted to public sector employees in the past year, and multi-year settlements could carry into 2024/25 while inflation in other parts of the economy abates.

Second, the growth we have seen in Canada's economy in the past couple of years has been facilitated by immigration-fueled population increases. That has created more taxpayers, but has also added to the head count for health care, education, transportation and other public services. Look for upcoming budgets to cite the crush of more people as a source of operating and capital spending growth.

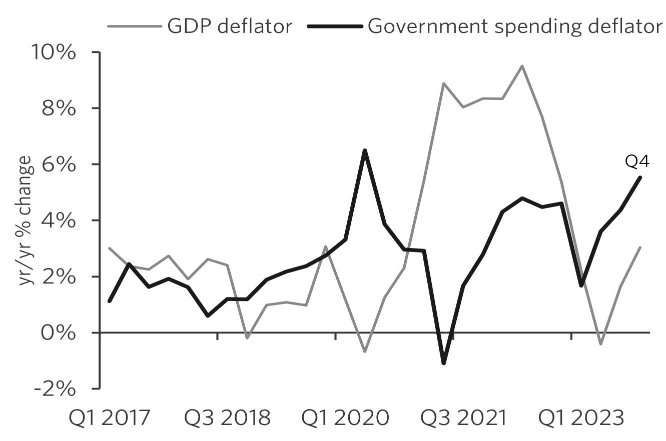
That would be more manageable if the additional population growth was also leading to a commensurate acceleration in economic output, and therefore, in revenues. But in recent years, that hasn't been the case, although it's tougher to prove that the fall in output per hour owes to less-productive newcomers. Whatever the cause, weak productivity growth has held back the output, and therefore tax revenues, that finance ministers can tap into.

There's also the productivity of government workers themselves. Measuring the real output of public administration workers isn't as easy as counting cars rolling off an assembly line. But the ratio of public sector employment to population has never been higher than in recent years.

We've yet to see evidence on what's driving those headcount increases, which have been particularly steep at the federal level. Is it a work-from-home issue? Greater per capita needs for public sector programs? Perhaps it's the so-called Baumol effect, in which public service jobs tend to have slower productivity growth than others, and the result is that these areas will need faster employment growth relative to other parts of the economy. Whatever the cause, it might be timely to assess whether there are efficiencies available in how we deliver government services.

There's one final reason why finance ministers are worried, despite polls showing that voters haven't put much weight on budget deficits. That's because one rapidly escalating source of spending growth doesn't win any votes at all: interest payments. Higher debt service costs already showed up in provincial budget projections released to date, and we'll be watching for the same trend elsewhere. Large pandemic-era debt build-ups, and now rising rates on refinancing debts, make debt servicing costs a very good reason to sweat the details on budget balances this year.

Chart: Inflation rate on government spending exceeds economy as a whole



Source: Statistics Canada, CIBC

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 4	-	-	-	-	-	-	-
Tuesday, March 5	-	-	-	-	-	-	-
Wednesday, March 6	8:30 AM	LABOUR PRODUCTIVITY Q/Q	(4Q)	(M)	-	-0.1%	-0.8%
Wednesday, March 6	9:45 AM	BANK OF CANADA RATE ANNOUNCE.	(Mar 6)	(H)	5.00%	5.00%	5.00%
Wednesday, March 6	10:00 AM	IVEY PMI	(Feb)	(L)	-	-	56.5
Thursday, March 7	-	AUCTION: 30-YR CANADAS $2.5B	-	-	-	-	-
Thursday, March 7	8:30 AM	BUILDING PERMITS M/M	(Jan)	(M)	-	-	-14.0%
Thursday, March 7	8:30 AM	MERCHANDISE TRADE BALANCE	(Jan)	(H)	$0.3B	$0.3B	-$0.3B
Friday, March 8	8:30 AM	EMPLOYMENT CHANGE	(Feb)	(H)	20.0K	21.4K	37.3K
Friday, March 8	8:30 AM	UNEMPLOYMENT RATE	(Feb)	(H)	5.8%	5.8%	5.7%
Friday, March 8	8:30 AM	CAPACITY UTILIZATION	(4Q)	(L)	-	-	79.7%

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, March 4	11:00 AM	Speaker: Patrick Harker (Philadelphia) (Non-Voter)	-	-	-	-	-
Tuesday, March 5	9:45 AM	S&P GLOBAL US SERVICES PMI	(Feb)	(L)	-	51.4	51.3
Tuesday, March 5	9:45 AM	S&P GLOBAL US COMPOSITE PMI	(Feb)	(L)	-	-	51.4
Tuesday, March 5	10:00 AM	FACTORY ORDERS M/M	(Jan)	(M)	-2.0%	-2.2%	0.2%
Tuesday, March 5	10:00 AM	ISM - SERVICES	(Feb)	(M)	53.0	52.9	53.4
Tuesday, March 5	10:00 AM	DURABLE GOODS ORDERS M/M	(Jan)	(H)	-	-	-6.1%
Tuesday, March 5	10:00 AM	DURABLE GOODS ORDERS EX-TRANS M/M	(Jan)	(H)	-	-	-0.3%
Tuesday, March 5	12:00 PM	Speaker: Michael S Barr (Governor) (Voter)	-	-	-	-	-
Wednesday, March 6	7:00 AM	MBA-APPLICATIONS	(Mar 1)	(L)	-	-	-5.6%
Wednesday, March 6	8:15 AM	ADP EMPLOYMENT CHANGE	(Feb)	(M)	-	150K	107K
Wednesday, March 6	10:00 AM	JOLTS Job Openings	(Jan)	-	8800K	-	9026K
Wednesday, March 6	10:00 AM	WHOLESALE INVENTORIES M/M	(Jan)	(L)	-	-	-0.1%
Wednesday, March 6	2:00 PM	FED'S BEIGE BOOK	-	-	-	-	-
Wednesday, March 6	10:00 AM	Speaker: Jerome H Powell (Chairman) (Voter)	-	-	-	-	-
Wednesday, March 6	12:00 PM	Speaker: Mary C. Daly (San Francisco) (Voter)	-	-	-	-	-
Wednesday, March 6	4:15 PM	Speaker: Neel Kashkari (Minneapolis) (Non-Voter)	-	-	-	-	-
Thursday, March 7	8:30 AM	INITIAL CLAIMS	(Mar 2)	(M)	-	-	215K
Thursday, March 7	8:30 AM	CONTINUING CLAIMS	(Feb 24)	(L)	-	-	1905K
Thursday, March 7	8:30 AM	GOODS & SERVICES TRADE BALANCE	(Jan)	(H)	-$63.0B	-$62.5B	-$62.2B
Thursday, March 7	8:30 AM	NON-FARM PRODUCTIVITY	(4Q)	(M)	-	3.1%	3.2%
Thursday, March 7	3:00 PM	CONSUMER CREDIT	(Jan)	(L)	-	$10.0B	$1.6B
Thursday, March 7	10:00 AM	Speaker: Jerome H Powell (Chairman) (Voter)	-	-	-	-	-
Thursday, March 7	11:30 AM	Speaker: Loretta Mester (Cleveland) (Voter)	-	-	-	-	-
Friday, March 8	8:30 AM	NON-FARM PAYROLLS	(Feb)	(H)	220K	190K	353K
Friday, March 8	8:30 AM	UNEMPLOYMENT RATE	(Feb)	(H)	3.7%	3.7%	3.7%
Friday, March 8	8:30 AM	AVERAGE HOURLY EARNINGS ALL EMPLOYEES M/M	(Feb)	(H)	0.2%	0.3%	0.6%
Friday, March 8	8:30 AM	AVERAGE WEEKLY HOURS ALL EMPLOYEES	(Feb)	(H)	-	34.3	34.1
Friday, March 8	8:30 AM	MANUFACTURING PAYROLLS	(Feb)	(H)	-	10K	23K
Friday, March 8	7:00 AM	Speaker: John C. Williams (Vice Chairman, New York) (Voter)	-	-	-	-	-

Week Ahead's market call

by Avery Shenfeld

In the **US**, it's once again payrolls week, and odds are that job gains in the vicinity of 200K will be sufficient to hold the unemployment rate at 3.7%, and we'll also see a rebound in hours worked that were distorted by weather in the prior month's survey week. Remember, however, that the US had a similar jobless rate in the prior cycle without inflationary consequences, so we'll be paying attention to the wage data in this report, and the job vacancy figures in the JOLTS report, looking for signs of a pay deceleration and a drop in open positions as key to moving towards rate cuts later this year. Fed speakers this coming week, including Powell, won't yet be ready to add much clarity on the timetable for that easing, particularly after a bit of an uptick in monthly core inflation.

In **Canada**, the central bank will also keep its cards close to its chest in terms of shedding much light on when we can expect the first rate cuts, opting to wait for a new forecast in the April Monetary Policy Report to fine tune its messaging. Rates will be left on hold on Wednesday, and changes in the statement could simply acknowledge both the modest overshoot versus its growth forecast, and some improvement in core inflation trends. The Bank likely wants to see some additional slack in the labour market, which we expect to see in Friday's LFS jobs data, hoping that will lead to cooling in wage gains ahead. The wage figures in the LFS series are the least reliable of the four series that the BoC tracks, so we won't put much weight on the week ahead's pay data.

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

(Friday, 8:30 am)

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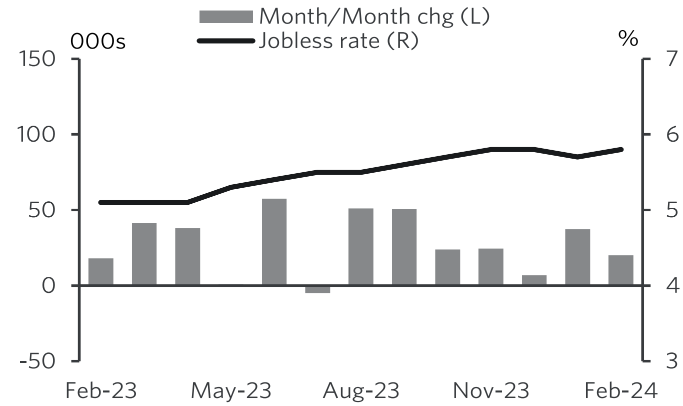
Variable	CIBC	Mkt	Prior
Employment (m/m)	20.0K	21.4K	37.3K
Unemployment rate	5.8%	5.8%	5.7%

Chart: Canadian employment



Source: Statistics Canada, Haver Analytics, CIBC

With job listings remaining well below prior peaks and the employee survey of jobs showing a much weaker trend recently, we expect the labour force survey of employment to show a weaker gain in February. The 20K increase we forecast would be well below the average pace of population growth recently, and unless participation declines further that would see the unemployment rate tick back up to 5.8%.

Wage growth has been running above 5% in this survey since last July, but that could be partly compositional as lower paying industries/positions typically see cutbacks first. With a fairly large monthly gain a year ago dropping out of the year-over-year calculation, wage growth for permanent employees could decelerate to 5.0%, from 5.3%.

Forecast implications — With employment growth likely to continue trailing that of the wider population until interest rates start to come down and the economy starts to accelerate, the unemployment rate is likely to continue gradually rising to just over 6% by mid-year. Further modest weakening in the labour market will likely bring a first rate cut in June.

Other Canadian releases: Merchandise trade—January

(Thursday, 8:30 am)

Canada's goods trade balance could see-saw back into positive territory in January, aided by slightly more positive oil exports (due to prices and volumes) and higher natural gas prices. Earlier released US data suggests that two-way trade in the auto industry also picked up following strike activity there towards the end of last year. Overall we forecast a +0.3bn trade surplus in January, following a deficit of similar magnitude in the prior month.

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

(Friday, 8:30 am)

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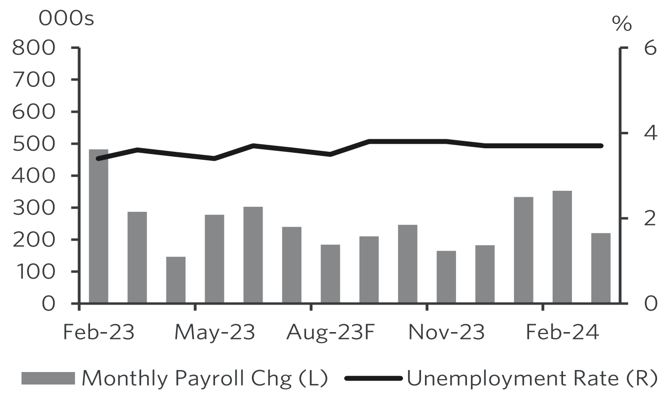
Variable	CIBC	Mkt	Prior
Employment (m/m)	220K	190K	353K
Unemployment rate	3.7%	3.7%	3.7%
Avg hourly earnings (m/m)	0.2%	0.3%	0.6%

Chart: US payroll employment



Source: BLS, Haver Analytics, CIBC

The winter cold won't be enough to take the heat out of the US jobs market. We expect the February payroll report to be another strong release with 220K jobs gained and a bounce back in average hours worked to 34.3 from the inclement weather during reference week of last month's survey. Over the past few months, broad-based hiring has picked up and we expect more of that trend in February. Our expectations is health care and government sectors to account for 60% of job gains and all other sectors, which behave more cyclically, to account for the remaining 40%. The unemployment rate and participation rate should remain unchanged at 3.7% and 62.5% respectively in the month. But the most important piece of the payroll report to watch out for once again will be the revisions. Given the size and volatility of revisions lately, there seems to be equal chances of either solidifying or nullifying the recent picture of the labour market.

Forecast implications — Q1 is shaping up to be another quarter of very strong household income gains. This should keep the momentum in consumption solid as US consumers' appetite will not be constrained by their wallets to start off 2024.

Market impact — Residual seasonality, the prospect of large revisions, firm underlying demand — there are a host of forces that can inject substantially volatility into next Friday's payroll report. We are betting on a number somewhat above the latest consensus figures by taking the recent data we have received at face value. The Fed's attention will be on how much the recent trend of job gains and labour supply changes over the previous three months rather than the February numbers themselves.

Other US Releases: ISM Services—February

(Tuesday, 10:00 AM)

The ISM Services Index is expected to come in at 53 in February, four notches lower than the January reading. Don't be glued to this survey as it mostly reflects sentiment, which should be solid given our expectations for payrolls.

JOLTS Job Openings—January

(Wednesday, 10:00 AM)

We expect the January JOLTS data to show job openings edge down in the month to 8800K after last month's slight resurgence. The job openings-to-unemployment ratio should stay unchanged in the month at 1.4. The pace of the downward movement in job openings has slowed materially since the summer.

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