THE WEEK AHEAD

April 1 - 5, 2024

The productivity malaise: a symptom, but not the disease

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

This week's speech by the Bank of Canada's Carolyn Rogers drew useful attention to the symptoms of Canada's productivity malaise. But we're still left without much progress towards a diagnosis, the first step towards a cure, and that might explain why public policy efforts in this area have come up short.

Productivity has a cyclical component, and a sluggish Canadian economy since mid-2022, against healthy economic growth stateside, likely added to the productivity gap with the US. A ticket taker at the theatre will be twice as productive if attendance doubles. But we can't dismiss the fact that Canada has been trailing the US in productivity growth for decades.

The impacts of soft productivity on living standards and inflation are serious, if not quite as dramatic as some make out. Greenspon, Stansbury and Summers found that Americans benefited from rising mean real wages as a reward for better productivity over the long run. But less wage inequality meant that Canadians kept pace in real median wage growth. The inflation impacts are cushioned by Canada's heavy reliance on imported consumer goods, and productivity growth in retail and wholesale trade hasn't been that soft over the period since 2019. But in other services and construction, weaker productivity growth could lift costs and prices.

While our malaise may be partly a reflection of softer capital spending, that too is a symptom, not the underlying disease. It's not helpful to berate CEOs for failing to spend on new equipment. If there were opportunities to save more on labour than the costs of adding equipment they would presumably do so, even if they aren't pressured by competitors. If there's a barrier to capital spending right now, it's high interest rates, and since 2014, the less hospitable investment climate for large scale oil and gas projects.

A few sectors stand out as long-term laggards or sources of current weakness. Construction output per hour is lower now than in 2019 in both the US and Canada, but we're still looking worse. A shortage of skilled trades is one hypothesis for that, but there's a need for better analysis of other impediments. It seems unlikely that we're digging holes by hand and using less machinery than in 2019. Canada has seen plunging output per hour in admin/support services, but that could be imprecision in how we measure real output, or a shift in the composition of activity within that hodge-podge sector.

Information and communications is another long term Canadian laggard. Statistics Canada research by Gu and Wilcox pointed to a less competitive market, and less pressure to keep up with others. But Canadian telecom firms also pay more for their spectrum needs, which all else equal would cut into the value-added attributed to their service.

Carolyn Rogers also cited a lack of competitive pressures in Canadian industries, but there's a catch-22 for Canada when it comes to the potential benefits of having more competitors: the impacts on scale. Firm-level data examined by Baldwin and others found that having more small firms was a major source of Canada's lower level of labour productivity versus the US. There are large economies of scale for firms that spend on technology equipment and software, since up-front costs don't differ much if these are accessed by 10,000 customers or 10 million. In general, larger firms will opt for a higher capital-labour ratio, and are rewarded with better output per labour hour. That poses a trade-off between the benefits of competition versus scale when you're looking at a country like Canada that has a much smaller national market. We need a deeper dive to assess that tradeoff.

Are lower cost, less-skilled temporary foreign workers undercutting Canada's output per hour, or incenting business to spend less on labour-saving technology? Adding immigrants with lower output per hour might not be a negative for the output per hour of those already here, even if it dilutes the average. Given our heavy reliance on immigration to counter the drag of an aging population, this is another area where hard facts, not guesswork, are needed.

We also need a better understanding of whether we're getting enough bang for the buck from public funds spent to promote innovative industries. Our tech entrepreneurs often end up cashing out with a sale to a US giant, so do we need more incentives for investors to encourage them to go public at home?

We haven't even touched on the usual laundry list of motherhood issues: interprovincial trade barriers, our corporate tax system, training, and so on. They might be part of the story, but there's a need for deeper research to know how much they matter. Statistics Canada has the firm-level data to take the lead in this, perhaps working with top-level academics. It's time to take a fresh look at the facts, so that we can better tailor any cure to the underlying disease.

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, April 1	10:30 AM	BUSINESS OUTLOOK SURVEY	(1Q)	(L)	-	-	-3.2
Tuesday, April 2	-	Manitoba Budget	-	-	-	-	-
Wednesday, April 3	-	-	-	-	-	-	-
Thursday, April 4	-	AUCTION: 5-YR CANADAS	-	-	-	-	-
Thursday, April 4	8:30 AM	MERCHANDISE TRADE BALANCE	(Feb)	(H)	$0.8B	-	$0.5B
Friday, April 5	8:30 AM	EMPLOYMENT CHANGE	(Mar)	(H)	25.0K	38.5K	40.7K
Friday, April 5	8:30 AM	UNEMPLOYMENT RATE	(Mar)	(H)	5.9%	5.8%	5.8%
Friday, April 5	10:00 AM	IVEY PMI	(Mar)	(L)	-	-	53.9

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, April 1	9:45 AM	S&P GLOBAL US MANUFACTURING PMI	(Mar)	(L)	-	-	52.5
Monday, April 1	10:00 AM	ISM - MANUFACTURING	(Mar)	(H)	47.5	48.5	47.8
Monday, April 1	10:00 AM	CONSTRUCTION SPENDING M/M	(Feb)	(M)	-	0.5%	-0.2%
Tuesday, April 2	10:00 AM	JOLTS Job Openings	(Mar)	-	8800K	-	8863K
Tuesday, April 2	10:00 AM	FACTORY ORDERS M/M	(Feb)	(M)	1.0%	1.0%	-3.6%
Tuesday, April 2	10:00 AM	DURABLE GOODS ORDERS M/M	(Feb)	(H)	1.4%	-	1.4%
Tuesday, April 2	10:00 AM	DURABLE GOODS ORDERS EX-TRANS M/M	(Feb)	(H)	0.5%	-	0.5%
Tuesday, April 2	12:00 PM	Speaker: John C. Williams (Vice Chairman, New York) (Voter)	-	-	-	-	-
Tuesday, April 2	12:05 PM	Speaker: Loretta Mester (Cleveland) (Voter)	-	-	-	-	-
Tuesday, April 2	1:30 PM	Speaker: Mary C. Daly (San Francisco) (Voter)	-	-	-	-	-
Wednesday, April 3	7:00 AM	MBA-APPLICATIONS	(Mar 29)	(L)	-	-	-0.7%
Wednesday, April 3	8:15 AM	ADP EMPLOYMENT CHANGE	(Mar)	(M)	-	150K	140K
Wednesday, April 3	9:45 AM	S&P GLOBAL US SERVICES PMI	(Mar)	(L)	-	-	51.7
Wednesday, April 3	9:45 AM	S&P GLOBAL US COMPOSITE PMI	(Mar)	(L)	-	-	52.2
Wednesday, April 3	10:00 AM	ISM - SERVICES	(Mar)	(M)	52.5	52.6	52.6
Wednesday, April 3	12:00 PM	Speaker: Austan D. Goolsbee, Chicago (Non-Voter)	-	-	-	-	-
Wednesday, April 3	12:10 PM	Speaker: Jerome H Powell (Chairman) (Voter)	-	-	-	-	-
Thursday, April 4	8:30 AM	INITIAL CLAIMS	(Mar 30)	(M)	-	-	-
Thursday, April 4	8:30 AM	CONTINUING CLAIMS	(Mar 23)	(L)	-	-	-
Thursday, April 4	8:30 AM	GOODS & SERVICES TRADE BALANCE	(Feb)	(H)	-$64.0B	-$65.7B	-$67.4B
Thursday, April 4	10:00 AM	Speaker: Patrick Harker (Philadelphia) (Non-Voter)	-	-	-	-	-
Thursday, April 4	12:45 PM	Speaker: Austan D. Goolsbee, Chicago (Non-Voter)	-	-	-	-	-
Thursday, April 4	2:00 PM	Speaker: Loretta Mester (Cleveland) (Voter)	-	-	-	-	-
Thursday, April 4	7:20 PM	Speaker: Alberto Musalem (St Louis)	-	-	-	-	-
Friday, April 5	8:30 AM	NON-FARM PAYROLLS	(Mar)	(H)	175K	216K	275K
Friday, April 5	8:30 AM	UNEMPLOYMENT RATE	(Mar)	(H)	3.9%	3.8%	3.9%
Friday, April 5	8:30 AM	AVERAGE HOURLY EARNINGS ALL EMPLOYEES M/M	(Mar)	(H)	0.2%	0.3%	0.1%
Friday, April 5	8:30 AM	AVERAGE WEEKLY HOURS ALL EMPLOYEES	(Mar)	(H)	-	34.3	34.3
Friday, April 5	8:30 AM	MANUFACTURING PAYROLLS	(Mar)	(H)	-	-	-4K
Friday, April 5	3:00 PM	CONSUMER CREDIT	(Feb)	(L)	-	-	$19.5B

Week Ahead's market call

by Avery Shenfeld

In the **US**, the JOLTS data now have less room to show a further drop in job vacancies, since for firms with 50 or more employees, the most recent levels had already fully normalized. We're expecting a bit more softness than the consensus on both payrolls and hourly earnings, but nothing dire enough to move up the timing for the first Fed rate cut into the first half of the year.

In **Canada**, we're not huge fans of the small-sample Business Outlook Survey, but for what its worth, it could show improved growth expectations. The question asks about whether the next four quarters will be better than the prior four quarters, and the bar is now lower to get a "yes", and respondents might also include a lift from expected interest rate cuts. Previous surveys already showed more temperate views on labour shortages and pricing policy, but there's room for a further deceleration in overall expectations for future wage increases and Canadian inflation. A moderate jobs gain in the labour force survey could once again fall short of population growth and nudge the jobless rate higher, while exports should get some help from oil volumes in Thursday's trade report.

Week Ahead's key Canadian number: Employment—March

(Friday, 8:30 am)

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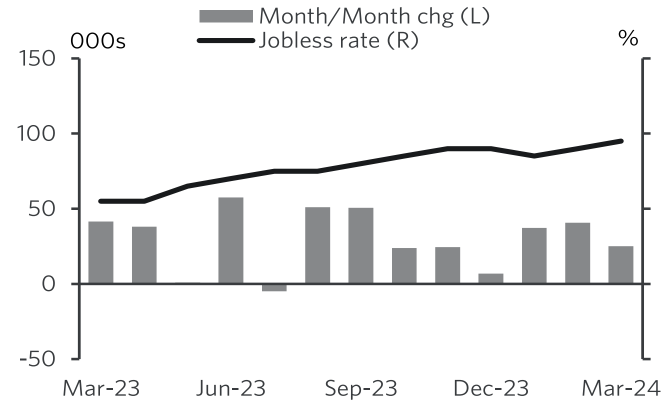
Variable	CIBC	Mkt	Prior
Employment change	25.0K	38.5K	40.7K
Unemployment rate	5.9%	5.8%	5.8%
Hourly wage rate	4.9%	-	4.9%

Chart: Canadian employment



Source: Statistics Canada, Haver Analytics, CIBC

Rising business bankruptcies and a decline in the number of active businesses overall will limit private sector hiring, resulting in employment growth once again falling short of the still elevated pace of population growth. That should see the unemployment rate continue to creep up closer to 6%. Increases in employment are once again likely to be driven largely by the public sector and possibly a rebound in self-employment.

Wage growth decelerated a little more than expected last month, but that progress could stall in March due to less favourable base effects. The largest seasonally adjusted increases in wages during 2023 came during the summer, and so we may have to wait until closer to mid-year for the annual pace of wage growth to decelerate meaningfully.

Forecast implications — If, as we expect, the Q1 pick up and growth proves to be a flash in the pan, the labour market will continue to soften with the unemployment rate peaking between 6-6.5% at mid-year. A loosening labour market will give the BoC the confidence it needs to start reducing interest rates, but the gradual way it is happening suggests no immediate urgency to cut in April.

Other Canadian releases: Merchandise trade—February

(Thursday, 8:30 am)

Oil export volumes and prices appears to have risen in February, although that improvement in nominal exports could be offset partly by lower natural gas prices due to the mild winter weather. Overall, we expect a $0.8bn surplus in February, up slightly from $0.5bn in the prior month.

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

(Friday, 8:30 am)

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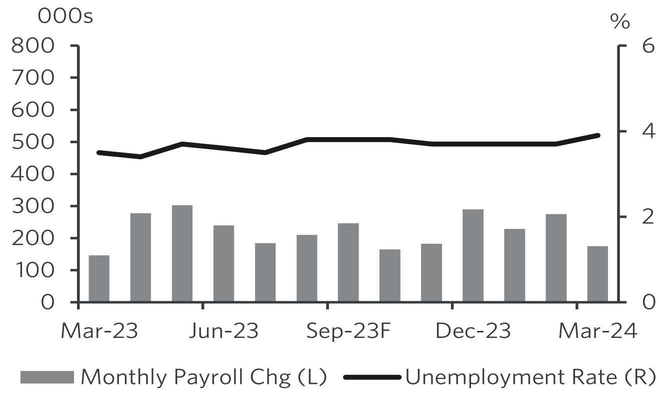
Variable	CIBC	Mkt	Prior
Employment (m/m)	175K	216K	275K
Unemployment rate	3.9%	3.8%	3.9%
Avg hourly earnings (m/m)	0.2%	0.3%	0.1%

Chart: US payroll employment



Source: BLS, Haver Analytics, CIBC

March payrolls should soften somewhat with 175K job gains in the month. The surge of undocumented workers, which is likely captured in the payroll survey but not the household survey, means 175K is likely close to break-even. The unemployment rate should stay unchanged at 3.9% and we expect wage growth to decelerate to a pace more consistent with 2% inflation at 0.2% m/m, as other wage indicators are already showing. The overall picture should be a jobs market that comes in weaker after a string of very strong reports.

Forecast implications — Growth in labor income has remained very steady over the past few quarters and the March jobs report should keep that trend intact for 24Q1. However, softer wage growth ahead and slightly less robust pace of job gains will mean income growth in 2024 won't be as strong. That, combined with a large pull forward of goods consumption, should bring consumption growth to a more modest pace going forward. Our GDP tracking for 24Q1 is now below trend growth at 1.6%.

Market impact — We are below consensus on job gains given the solid string of employment increases recently. Powell's concern will continue to be about the balance of labor supply and labor demand looks in the month. That means another tick up in the unemployment rate, not caused by changes in the labor force, will worry them.

Other US Releases: ISM Manufacturing—March

(Monday, 10:00 am)

The ISM Manufacturing Index should be near prior weak levels as firms' increasingly feeling the effects of monetary policy restraint and expectations of slowing sales. Both hard and soft data suggest the manufacturing sector is losing steam in the face of a sluggish global economy.

JOLTS Job Openings—February

(Tuesday, 10:00 am)

We expect the February JOLTS data to show job openings stayed essentially unchanged from January. The vacancy-to-unemployment ratio should stay steady at 1.4. With most of the elevated job openings due to in-person small businesses like restaurants, this indicator is likely structurally higher and is telling us the labor market is moving into better balance. Keep an eye out for the hiring and quits rate which have moved below their pre-pandemic levels.

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