Economics

THE WEEK AHEAD

July 26-30, 2021

Should we fret the Canadian economy's recent reliance on housing?

by **Royce Mendes** royce.mendes@cibc.com

The fact that residential investment now accounts for a larger share of the economy than business investment has some worried that it's crowding out more productive capital outlays or that a cooling off will leave a hole to fill. How much should we fret an end to the past year's residential investment boom?

It's important to first lay out what exactly this data represent and what it doesn't. Residential investment measures three components of economic activity: construction, renovation and ownership transfer costs. It's not a measure of home prices and doesn't say anything about the affordability or financial stability issues that have come with the surge in home prices during the pandemic.

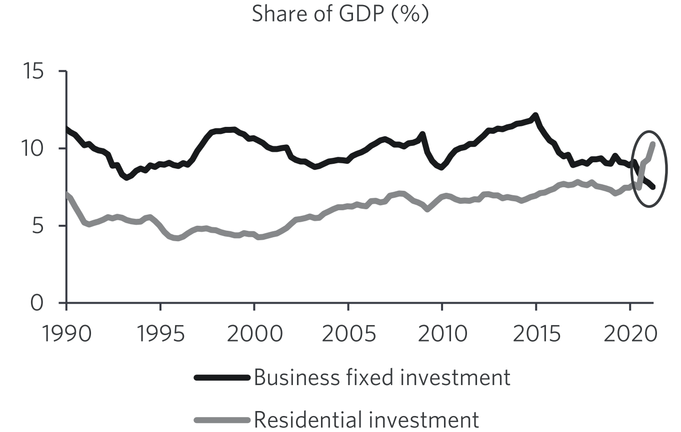
Typically, residential investment has been positively correlated with business investment, given that general economic conditions seem to drive the performance of both. The past year is, therefore, an anomaly, with residential and business investment moving in opposite directions. That has less to do with crowding out and more to do with the nature of the pandemic. Households sought to build or move to larger homes for work, school and recreation. Conversely, most businesses were hesitant to make major investments due to the incredible uncertainty of the pandemic.

The boom in residential investment was in part driven by new construction and renovation. Far from impeding business activity, private sector companies built and renovated those houses and also created the inputs used for construction, although that doesn't seem to have translated into more than a few thousand extra jobs. Increasing the supply of housing is also the best way to ease affordability issues, leaving more money in the pockets of consumers to spend on goods and services sold by businesses unrelated to the housing market.

The single greatest driver of the surge in residential investment was, however, ownership transfer costs, which include real estate commissions, land transfer taxes and legal fees. Now that Canadians are leaving their homes more often, demand for housing is cooling off after a period of historic strength. As a result, we do expect this component of GDP to come back down to earth. But increased activity in the resale housing market also didn't translate into a wave of newly minted real estate agents and support staff. Employment tied to real estate and leasing is at the same level it was pre-pandemic. So, while the cooling in market activity will dent the incomes of agents and the profits of brokers, it probably won't meaningfully delay a return to full employment.

The reopening that is underway also seems to be coinciding with a slowdown in other components of residential investment, such as construction. But, by that same token, companies not doing business in the housing market are also feeling more confident about making investments rather than stockpiling cash, given that vaccinations have reduced the likelihood of another round of harsh shutdowns. If so, it would see the abnormal negative correlation between housing and business investment continue for a little while longer. But, keep in mind, that a fall in residential investment will not cause a rise in business investment, it's still that other variable driving both: the pandemic.

Chart: Covid-related factors have had residential investment making up a larger share of GDP than business investment over the past year



Source: Statistics Canada, CIBC

Week Ahead Calendar And Forecast—Canada

H, M, L = High, Medium or Low Significance

SAAR = Seasonally Adjusted Annual Rate

Consensus Source: Bloomberg

Date	Time	Economic Releases, Auctions and Speakers	Month	Significance	CIBC	Consensus	Prior
Monday, July 26	-	Government Bond Purchase Program (GBPP): 2-YR	-	-	-	-	-
Tuesday, July 27	-	Government Bond Purchase Program (GBPP): 10-YR	-	-	-	-	-
Wednesday, July 28	-	Government Bond Purchase Program (GBPP): 5-YR	-	-	-	-	-
Wednesday, July 28	8:30 AM	CPI M/M	(Jun)	(H)	0.4%	0.4%	0.5%
Wednesday, July 28	8:30 AM	CPI Y/Y	(Jun)	(H)	3.2%	3.2%	3.6%
Wednesday, July 28	8:30 AM	CPI Core- Common Y/Y%	(Jun)	(M)	1.9%	-	1.8%
Wednesday, July 28	8:30 AM	CPI Core- Median Y/Y%	(Jun)	(M)	-	-	2.4%
Wednesday, July 28	8:30 AM	CPI Core- Trim Y/Y%	(Jun)	(M)	-	-	2.7%
Thursday, July 29	-	Government Bond Purchase Program (GBPP): 30-YR	-	-	-	-	-
Thursday, July 29	-	AUCTION: 30-YR CANADAS $3B	-	-	-	-	-
Thursday, July 29	8:30 AM	PAYROLL EMPLOYMENT, EARNINGS & HRS	-	-	-	-	-
Friday, July 30	8:30 AM	GDP M/M	(May)	(H)	-0.3%	-0.4%	-0.3%
Friday, July 30	8:30 AM	INDUSTRIAL PROD. PRICES M/M	(Jun)	(M)	-	-	2.7%
Friday, July 30	8:30 AM	RAW MATERIALS M/M	(Jun)	(M)	-	-	3.2%

Week Ahead Calendar And Forecast—United States

H, M, L = High, Medium or Low Significance

SAAR = Seasonally Adjusted Annual Rate

Consensus Source: Bloomberg

Date	Time	Economic Releases, Auctions and Speakers	Month	Significance	CIBC	Consensus	Prior
Monday, July 26	-	AUCTION: 2-YR $60B	-	-	-	-	-
Monday, July 26	10:00 AM	NEW HOME SALES SAAR	(Jun)	(M)	780K	800K	769K
Monday, July 26	10:00 AM	NEW HOME SALES M/M	(Jun)	(M)	1.4%	4.0%	-5.9%
Tuesday, July 27	-	AUCTION: 5-YR $61B	-	-	-	-	-
Tuesday, July 27	8:30 AM	DURABLE GOODS ORDERS M/M	(Jun P)	(H)	2.2%	2.1%	2.3%
Tuesday, July 27	8:30 AM	DURABLE GOODS ORDERS EX-TRANS M/M	(Jun P)	(H)	1.0%	0.8%	0.3%
Tuesday, July 27	9:00 AM	HOUSE PRICE INDEX M/M	(May)	(M)	-	1.6%	1.8%
Tuesday, July 27	9:00 AM	S&P CORELOGIC CS Y/Y	(May)	(H)	-	-	14.88%
Tuesday, July 27	10:00 AM	CONF.BOARD CONSUMER CONFIDENCE	(Jul)	(H)	125.0	124.3	127.3
Tuesday, July 27	10:00 AM	RICHMOND FED MANUF. INDEX	(Jul)	(M)	-	20	22
Wednesday, July 28	-	AUCTION: 2-YR FRN $28B	-	-	-	-	-
Wednesday, July 28	7:00 AM	MBA-APPLICATIONS	(Jul 23)	(L)	-	-	-4.0%
Wednesday, July 28	8:30 AM	ADVANCE GOODS TRADE BALANCE	(Jun)	(M)	-$88.7B	-$88.0B	-$88.1B
Wednesday, July 28	8:30 AM	WHOLESALE INVENTORIES M/M	(Jun P)	(L)	-	1.2%	1.3%
Wednesday, July 28	8:30 AM	RETAIL INVENTORIES M/M	(Jun)	(H)	-	-	-0.8%
Wednesday, July 28	2:00 PM	FOMC RATE DECISION (UPPER BOUND)	(Jul 28)	(H)	0.25%	0.25%	0.25%
Wednesday, July 28	2:00 PM	FOMC RATE DECISION (LOWER BOUND)	(Jul 28)	(H)	0.00%	0.00%	0.00%
Wednesday, July 28	2:30 PM	Speaker: Jerome H Powell (Chairman) (Voter)	-	-	-	-	-
Thursday, July 29	-	AUCTION: 7-YR $62B	-	-	-	-	-
Thursday, July 29	8:30 AM	INITIAL CLAIMS	(Jul 24)	(M)	-	370K	419K
Thursday, July 29	8:30 AM	CONTINUING CLAIMS	(Jul 17)	(L)	-	-	3236K
Thursday, July 29	8:30 AM	GDP (annualized)	(Q2A)	(H)	8.9%	8.4%	6.4%
Thursday, July 29	8:30 AM	GDP DEFLATOR (annualized)	(Q2A)	(H)	6.0%	5.4%	4.3%
Thursday, July 29	10:00 AM	PENDING HOME SALES M/M	(Jun)	(M)	-	0.8%	8.0%
Friday, July 30	8:30 AM	EMPLOYMENT COST INDEX	(Q2)	(M)	-	0.9%	0.9%
Friday, July 30	8:30 AM	PCE DEFLATOR Y/Y	(Jun)	(H)	4.2%	4.1%	3.9%
Friday, July 30	8:30 AM	PCE DEFLATOR Y/Y (core)	(Jun)	(H)	3.8%	3.7%	3.4%
Friday, July 30	8:30 AM	PERSONAL INCOME M/M	(Jun)	(H)	-0.7%	-0.6%	-2.0%
Friday, July 30	8:30 AM	PERSONAL SPENDING M/M	(Jun)	(H)	1.0%	0.6%	0.0%
Friday, July 30	9:45 AM	CHICAGO PMI	(Jul)	(M)	-	64.0	66.1
Friday, July 30	10:00 AM	MICHIGAN CONSUMER SENTIMENT	(Jul F)	(H)	-	80.8	80.8

Week Ahead's market call

by Royce Mendes

In the **US**, we're looking for another strong GDP print next week, which will see that indicator surpass its pre-pandemic level. While that performance will confirm that the economy is far along the path to recovery, Federal Reserve officials aren't likely to make any major changes to their guidance on QE or rates on Wednesday. Monetary policymakers are waiting to see more healing in the labour market before changing tact. While household incomes likely fell in June as some states moved to cut off extra unemployment benefits early, look for spending to have accelerated with more services available. Consumer confidence is expected to have remained around pre-pandemic levels throughout July, suggesting momentum in household spending has likely continued.

In **Canada**, it will be worth keeping an eye on the inflation data next week to see if there are signs that demand tied to the reopening translated into higher prices for some goods and services in June. The GDP data for May is old news, with the statistical agency already suggesting there was another modest contraction in its flash estimate. We do, however, expect that the early look for June GDP will show a solid rebound coinciding with the relaxation of restrictions across the country.

Week Ahead's key Canadian number: Consumer price index—June

(Wednesday, 8:30 am)

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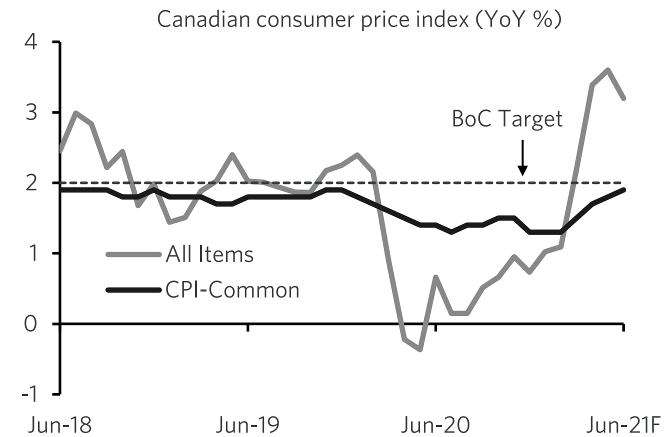
Consumer price index	CIBC	Mkt	Prior
CPI NSA (m/m)	0.4%	0.4%	0.5%
CPI (y/y)	3.2%	3.2%	3.6%
CPI-common (y/y)	1.9%	-	1.8%

Chart: Canadian Consumer price index



Source: Statistics Canada, Haver Analytics, CIBC

The headline annual inflation rate is set to show a deceleration for June. That's in part because of base effects and in part because of new weights being assigned to components. A portion of the recent acceleration in headline inflation had been simply due to the calculation comparing current prices with those twelve months prior, during the worst of the pandemic. However, as time marches forward those effects are fading. The Consumer Price Index is also getting a brand new set of weights, which will lower the basket share assigned to gasoline. Gas prices had been steadily increasing and continued to do so at an above-average pace in June. Reducing that weight will see the contribution from those increases to year-over-year and month-over-month inflation more muted than would have been the case with the previous weights.

Aside from those two technical factors, there will likely still be evidence that supply chain bottlenecks are pushing up the prices of cars. Moreover, with many services reopening in June, there might also be evidence of businesses raising prices to deal with the rush of demand and make up for past losses. Indeed, we expect the Bank of Canada's core common component measure of underlying inflation to actually accelerate a tick.

Forecast Implications — Inflation is likely to remain around 3% for the rest of the year. However, the Bank of Canada continues to see most of this as transitory and will keep rates on hold until the economy reaches full employment.

Other Canadian releases: GDP—May

(Friday, 8:30 am)

Statistics Canada already let the cat out the bag with its flash estimate of May GDP which suggested a further contraction of 0.3% due to the shutdowns that remained in place across the country. That said, the statistical agency will give us a sneak peek of the economy's performance in June. With Covid cases falling, many provinces began to relax restrictions early in the month. That should translate into a solid bounce in economic activity, particularly in many services sectors. We've penciled in a growth rate of 0.8% for June, which would translate into a 2.5% annualized increase for Q2, roughly in line with the Bank of Canada's latest projections. However, our forecast for June is admittedly based on very limited information for the month.

Week Ahead's key US number: Real GDP—Q2 Advance

(Thusday, 8:30 am)

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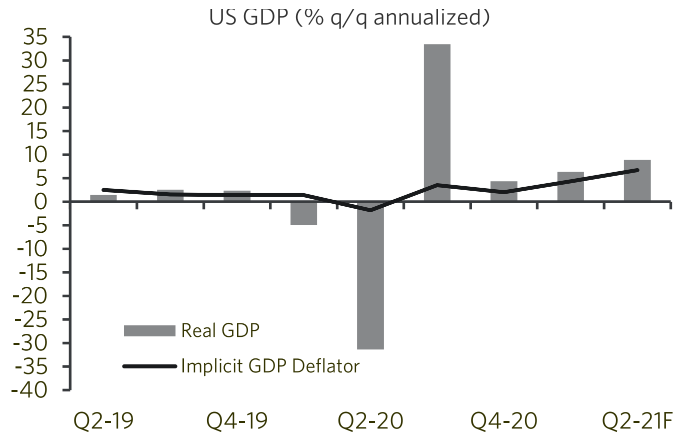
GDP	CIBC	Mkt	Prior
GDP q/q annualized	8.9%	8.4%	6.4%
GDP Deflator	6.0%	5.4%	4.3%

Chart: US GDP



Source: BEA, Haver Analytics, CIBC

All signs points to an acceleration in the US economy in the second quarter as the reopening gained momentum and fiscal stimulus payments received at the end of Q1 provided additional spending power for households. Our forecast for GDP growth of 8.9% annualized over Q2 reflects an expected strong showing from consumers that unleashed pent-up demand. Although inflation also jumped, that didn't appear to deter purchases. However, supply chain issues will have limited growth in auto sales.

Business investment in equipment looks to have provided a boost to growth as shipments of core capital goods continued at a brisk pace. Strong domestic demand will have been partly satiated by higher imports, likely outpacing gains in exports to weaker international economies in comparison. The housing market lost momentum in terms of both starts and sales, suggesting a drag from residential investment.

Forecast Implications — With Americans still sitting on ample excess cash, consumers should continue to drive solid growth in the second half, coinciding with an acceleration in the labor market as unemployment benefit top-ups end. That will work to promptly eliminate economic slack, giving the Fed enough confidence in the recovery to announce an early 2022 tapering in QE at the September meeting.

Market Impact — We're slightly above the consensus forecast, which could boost the greenback and see bond yields rise.

Other US Releases: Durable goods orders—June

(Tuesday, 8:30 am)

Durable goods orders likely rose by 2.2% in June, extending the strong performance seen over most of the pandemic. That would reflect a continued recovery in commercial aircraft orders as air traffic returns, added to an expected rise in core capital goods categories in line with the uptick in capacity utilization in the industrial sector. Excluding the transportation component, growth in orders likely accelerated to 1.0%. Importantly, the delivery period for components impacted by the semiconductor shortage is likely to be delayed, therefore translating into GDP growth with more of a lag than usual.

Personal income and outlays—June

(Friday, 8:30 am)

Household income likely fell by 0.7% in June as government benefits faded, offsetting gains in labor market income. Still, with elevated savings and reopened services to spend funds on, total spending likely rose by a respectable 1.0%. Price pressures likely heated up, in line with the earlier released CPI data. Core PCE prices, the Fed's preferred measure of inflation, likely accelerated to 3.8%, reflecting a mix of supply disruptions and strong demand. While those factors will fade ahead, a closing of economic slack later this year should be enough to keep inflation well above the 2% mark in 2022, compelling the Fed to hike rates in the second half of that year.

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