Focus

Feature Article

Services Demand: The Third Leg of Resiliency

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Top O' the Maelstrom to Ya

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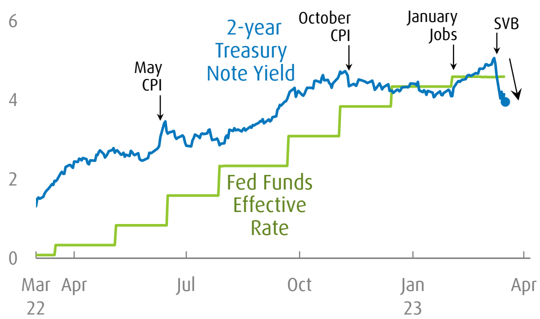
- *mael'strom, n.* 1) a powerful often violent whirlpool sucking in all objects within a given radius. 2) a great confusion.

Markets are still struggling to find their equilibrium a week after regulators took control of SVB, whose woes have sparked intense liquidity concerns among regional banks. A back-and-forth week saw the focus ping-pong across continents, and a wide variety of both official and private support systems were put in place to calm the waters. The late-week news that banks tapped the Fed discount window for a record $152.9 billion in the week to March 15, and the new Bank Term Funding Program (BTFP) for another $11.9 billion, was seen as a sign of high stress, further roiling markets. The large figure also put the $30 billion in fresh deposits from 11 banks for First Republic and the SFr50 billion (US$54 billion) line for Credit Suisse into perspective.

Chart 1
Rollercoaster
United States (% : as of March 17, 2023, noon)



Sources: BMO Economics, Haver Analytics

While clearly a fluid situation, **the major net market move has been a massive step down in expectations of central bank rates and a secondary hit to oil prices**. This combination has sliced bond yields; at one point, U.S. two-year yields were down 130 bps in the space of five trading days, by far the largest such adjustment since October 1987. By Friday morning, they were back below 4%, down 65 bps on the week. Equity markets, while under pressure, have mostly played it cool (aside from bank stocks), with the Nasdaq rising this week and the S&P 500 nudging up. The TSX wasn't as fortunate, as a $10 drop in oil prices (to $66) and a heavy financial services weighting clipped the index to a 2023 low.

Amid the turbulence, the Fed must now balance the financial instability against still-hot inflation. While this week's key CPI report was mostly as expected, and the PPI was even on the mild side, the reality is that core inflation simply is not budging. Based on almost any metric of core and almost any time period over the past year, the message is the same—underlying inflation is settling into a range just above 5%. We noted that the 0.45% rise in core CPI in February, which is equivalent to a 5.6% annualized pace, was larger than anything seen in the 25 years prior to the pandemic, but was merely in line with the average of the past year. Certainly, there are plenty of grounds for optimism on the outlook for milder inflation—the steep drop in oil, much-improved supply chains, slipping home prices, and business surveys pointing to easing price gains. But the Fed must be unnerved by the stickiness of core prices.

Taking these heavily conflicting factors together, we are holding to our call that the Fed will lift rates 25 bps at next week's meeting to 4.75%-to-5.00%, assuming no major new news breaks before the meeting. Michael digs into all the details in his Thought, but we are also maintaining the view that they will deliver one final hike in May, and then hold at that 5.00%-to-5.25% range through the second half of the year. Even amid the violent swings of the past few weeks, this was our original call—which swiftly went from being far below the market, to well above, to almost right in line, in the space of about 10 days. Of course, the crucial point is that the risks to our call have swung violently from the high side to the low side. But the ECB's icyveined decision to hike 50 bps this week shows that central banks believe that the inflation fight must proceed, even as they attempt to ringfence the financial risks.

And what about the Bank of Canada? Just one week after stepping to the sidelines —*can it only be a week?*—market pricing has also adjusted dramatically for the Bank. A pair of strong employment reports to start the year, and a string of other solid indicators for January, had many looking for the Bank to resume rate hikes later this year, at least until last Friday. Now, after the global banking turmoil, markets are priced for at least two rate cuts by the end of 2023. And while the drop in bond yields hasn't been quite as ferocious as stateside, GoC 2-year yields have plunged 70 bps in barely a week, with the important 5-year falling almost the same to below 3%.

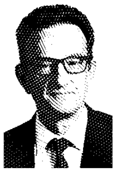
Despite the aggressive market pricing, the bar for rate cuts is very high. After all, the combination of a deep drop in bond yields, a weak currency, and broadly flat equities means that financial market conditions have loosened. There are even signs that the humbled housing sector is picking itself off the mat. While sales were down 40% y/y in February, and prices off 16% from the record high a year ago, a dearth of new listings has improved the market balance. And, the BoC's pause, combined with the sharp drop in longer-term yields, will give borrowers some confidence that the worst is over for rates. We don't look for a quick turn in the sector—not with household debt at 180% of income, butting up against 425 bps of rate hikes in the past year—but it may soon stop dragging heavily on growth.

Canada's inflation rate is one of the lowest in the industrialized world, but it's still running more than double the BoC's target. Tuesday's CPI report should largely echo the U.S. result, although a small seasonally adjusted rise could clip the headline rate to 5.3% (versus 8.5% in the Euro Area, and 6.0% for the U.S.). Gasoline prices have vanished as an inflation driver, dropping 12% from year-ago levels in recent days, but core has stepped into the void. We look for most core metrics to hold close to 5% in February, not far from U.S. and Euro Area trends.

Besides the ongoing battle with inflation, **central banks will also need to determine to what extent the economic outlook has been hit by the financial squall**. In a very early sign, the University of Michigan's survey found consumer sentiment pulled back more than expected in March, but it's still well above last summer's lows. The drop in gasoline prices has likely played a big role there, as 1-year inflation expectations of 3.8% are at their lowest since early 2021. Even the five-year inflation outlook has dipped to 2.8%—recall, a jump in this metric above 3% last summer was a key reason the Fed accelerated the pace of rate hikes to 75 bps a clip.

More broadly, the inevitable tightening in credit conditions that will emerge from the turmoil will dampen economic growth. Full disclosure, up until the past week, our call for a shallow recession in North America was looking dubious, especially given the relentless strength in employment and incomes. Unfortunately, the call now looks all too realistic. Pronounced softness in regional manufacturing surveys in March suggests that growth may finally be succumbing to the barrage of rate hikes. And while sub-200k initial jobless claims show the job market hasn't buckled, the mounting layoff wave (Meta this week) points to a cooling ahead. Even with the surprisingly resilient start to the year, we look for GDP growth to average just 0.7% in both the U.S. and Canada for 2023—only four of the past 40 years have been slower.

Fed Preview: Banking Stress, Yes, But Inflation Not Suppressed



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Market expectations of **the FOMC's policy decision** on March 22 have whipsawed wildly in the past couple weeks. After Chair Powell's hawkish congressional testimony on March 8, which followed reports of stronger-than-expected payroll employment growth and faster-than-expected core CPI inflation, the market was pricing in almost 90% odds of a 50 bp rate hike and a total 100 bps of tightening by year-end. Three business days later, as the collapse of Silicon Valley Bank and Signature Bank were confirmed, market pricing flipped to better-than-even odds of a pause and more than 80 bps of easing by year-end. Roughly 3½ days later, at the time we published, the market had a hybrid scenario, almost 75% odds of a 25 bp rate hike which gets fully priced in next meeting (May 3) along with 10% odds of another quarter-point move. Then, there's more than 85 bps of easing by the end of the year.

Whipsawing Fed expectations were also reflected in the bond market, particularly in the pogo stick called 2-year yields. At the start of February, just before the huge 504,000 jump in January payrolls, (constant maturity) 2-year yields were under 4.10% and by Powell's congressional confab they were 5.05%. Exactly a week later, amid investors' banking sector heebie-jeebies, yields had plummeted to under 3.95%, before a short-lived bounceback (by publishing time, we were again under 4.00%).

Markets often overreact to data and developments, but some whipsawing was warranted in this situation. **The second- and third-largest bank failures in U.S. history pose risks to financial stability and the economic outlook.** Other things equal, these are risks that could stop the FOMC's tightening campaign in its tracks, if not turn it around. **But these risks weren't left unaddressed.** Together, the Treasury, Fed and FDIC took actions to ameliorate them. First, the FDIC protected all depositors of these two institutions, whether their funds were insured or not (invoking the 'systemic risk' exemption with any losses covered by a 'special assessment' on all banks). Second, the Fed established a new Bank Term Funding Program (BTFP), permitting all banks to pledge their Treasury securities as collateral, at par value, for loans up to a one-year term (Treasury is backstopping the program with $25 billion of credit protection). The higher collateral value for Treasuries would apply at the discount window as well.

Three days later (March 15), the Fed had extended $302.9 billion of credit to the banking system (compared to a week ago). With the FDIC guaranteeing repayment, $142.8 billion was lent to SVB and Signature to cover their deposits. The BTFP was tapped for $11.9 billion and discount window borrowing (primary credit) was $148.3 billion. The latter figure suggests that other regional and small banks were impacted by fearful depositors withdrawing their funds (which is worrisome). Essentially, we had a textbook display of one the key roles of a central bank, to be the lender of last resort.

Despite these potent macroprudential actions, **negative risks to the economic outlook likely linger** via the potential for reduced confidence and credit availability, along with any net tightening of broader financial conditions. These negative risks will likely be considered at the FOMC meeting.

However, also probably considered will be the recent labour market and CPI reports which point to **a more stubborn inflation process**. After the above-mentioned 504,000 print for payrolls, February employment growth was a larger-than-expected

311,000. Meanwhile, although January's job openings dropped by 410,000 to 10.8 million, labour demand (payrolls + openings) still hit a new cycle high. This means the big imbalance between demand and supply continues to stoke wage pressures. On the inflation front, the monthly increase in the core CPI accelerated to 0.5% in February from a pair of 0.4%s, which is what the market's CPI proxy of the Fed's PCE 'supercore' also did.

From the Fed's risk management perspective, the risk of tightening too much (and causing a deeper economic downturn than is required to restore price stability) and the risk of not tightening enough have both risen. And, we reckon the Fed's policy scale still tips to the latter risk (it probably would have tipped the other way if not for the macroprudential moves).

As such, **we have not changed our expectation for a 25 bp rate hike on March 22**, although we now perceive net downside risk to our call compared to net upside risk before the banking crisis. Additionally, against a background of falling oil prices (headline inflation's best friend), concerns over Credit Suisse (along with when and where the next banking shoe will drop, if at all) are also prodding the downside risk. Indeed, we wouldn't be surprised to see the first FOMC dissenting vote this tightening cycle.

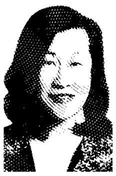
The expected rate hike would lift the fed funds target range to 4.75%-to-5.00% and bring cumulative tightening to 475 bps. The former is the highest since 2007 (just before the Global Financial Crisis and Great Recession); the latter is the largest since the Fed began targeting fed funds in the 1980s. And we still judge the Fed will have one more quarter-point move up its sleeve, before pausing for the remainder of the year in the wake of an unfolding mild recession and further disinflation, which then sets the stage for rate cuts commencing early 2024.

This pair of hikes pushes policy rates above 5%, which we consider to be the 'minimal terminal' because it starts resulting in non-negative real policy rates, depending on which inflation trend is adopted. To wit, over the past one-, three-, six-, nine- and 12-month intervals, the changes in the core CPI and the market's CPI proxy for the PCE 'supercore' were all at least 5.1% annualized (with some pushing 6%). Indeed, it's this stickiness around 5% (along with the assumption that banking stress calms) that keeps us in the **no-rate-cuts camp for this year**, despite a forecasted mild recession.

Along with the Fed's policy statement, we'll get a fresh **Summary of Economic Projections** (SEP). Back in December, 17 of 19 FOMC participants were projecting a 2023-end fed funds rate above 5.00%, ranging from 4.875% to 5.625% with a median of 5.125%. The median then had 100 bps of easing next year. Given the offsetting risks to the outlook, we could see little change here. For the record, the other 2023-24 forecast medians (Q4/Q4 or Q4) were as follows: real GDP growth 0.5% and 1.6%, unemployment rate 4.6% and 4.6%, PCE inflation 3.1% and 2.5%, and core PCE inflation 3.5% and 2.5%. The theme of the last SEP was that despite slower growth and higher joblessness, higher policy rates were still required to tame inflation which was itself marked higher. In effect, the Fed was acknowledging the stubbornness of the inflation process. We suspect that theme will permeate the new SEP as well. (Note: The individual projections that feed into the SEP can be adjusted until the meeting.)

Finally, we'll be listening closely to **Chair Powell's presser**, attempting to answer the key question: To what degree, if at all, has the FOMC's hawkishness from 1½ weeks ago been dampened by banking sector stress? Given recent volatility, we suspect many Fed calls are going to be recalibrated in the wake of the Fed's latest pronouncements.

ECB Follows Through: +50



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True to its word, the **ECB raised the three key interest rates by 50 bps** for the third meeting in a row, bringing the refi rate to 3.50%, the marginal lending facility to 3.75%, and the deposit facility to 3.00%. That's a total of 350 bps of tightening over a span of nine months. And there would be more coming, probably of the same size, if it weren't for what happened over the past week. But given the extreme volatility in financial markets, the central bank wisely dropped its forward guidance. It also looks like a few of the extreme hawks were put in their place as the Press Statement noted that the "*elevated level of uncertainty reinforces the importance of a data-dependent approach*". Can one expect a more chastened head of Austria's central bank in the coming days? Unlikely. Robert Holzmann may not repeat his push for four more 50 bp rate hikes, but he will emphasize the great need to bring inflation back to 2% quickly. That would be fair.

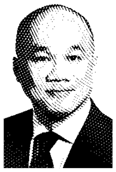
The March decision was backed by a "*very broad majority*" while "*3 or 4*" wanted to give the situation more time to see how it unfolds. That minority did not consider a 25 bp hike, they considered staying on hold and only agreed to the 50 bp move after the SNB stepped in.

The press conference did not unveil too many interesting nuggets except perhaps President Lagarde's comment that if their baseline were to persist, then "*we have a lot more ground to cover*." It is unfortunate that the new growth and inflation forecasts are already old as they were prepared before the chaos that ensued in markets last week.

Anything short of a 50 bp hike would have made the ECB look soft. But President Lagarde toned down the hawkishness to emphasize the data-dependency of their decision-making, and that it will be done on a meeting-by-meeting basis. And of course, they are "*ready to respond*" if needed, to ensure price and financial stability.

Bottom Line: The ECB is not finished, not with core CPI at a record high. We still expect more hikes… maybe not of the 50 variety, but spread out over the course of a couple of meetings and not necessarily back to back. But terminal is still at 4.00%. For now. Let's take it on a meeting-by-meeting basis, and watch the data. (Where have I heard that before?)

Crude Oil Outlook: Is It Time to Worry?



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Given how **benchmark crude prices** have tumbled in recent days, we suspect that nerves in the oil market are going to be running high for a while longer. West Texas Intermediate (WTI) crude is hovering around US$65-70/bbl, compared to $80 at the beginning of the month. The sudden drop, sparked by the dramatic events involving Silicon Valley Bank and Credit Suisse, has unsurprisingly led to a reassessment of recession risks and the potential impact on global oil demand. This has even forced some crude oil bulls to run for cover and hedge themselves against the downside risk to prices.

If the price of crude oil is going to make a comeback, it looks like it will have to take place in the second half of the year. This is because the oil market will likely remain in surplus territory until at least the middle of the year. The International Energy Agency's (IEA) flagship monthly Oil Market Report essentially confirmed this by recently highlighting that *"global oil supply is outstripping still lacklustre demand"*. This has resulted in global crude stocks reaching their highest levels since 2021Q3.

Nonetheless, **prospects for a second-half recovery in prices remain murky** as much will depend on two critical factors: China's reopening and OPEC+'s production strategy. The good news is that China's economy is on the (gradual) road to recovery, confirmed by the latest high-frequency data. Of note, retail sales grew 3.5% y/y in the first two months of the year (vs. -1.8% in December), showing that Chinese consumers are on the move again. Meanwhile, the country's big three airlines reported that air passenger load factors have rebounded, averaging 74% in February (vs. 66% a year ago). This is in line with Beijing's goal to bring total air traffic back to 75% of pre-pandemic levels, which would certainly help boost demand for jet fuel. However, one cannot dismiss the possibility that China alone may not be able to drive a robust recovery in global oil demand. Indeed, the IEA's 2023 forecast is for global oil demand to increase by an average of 2 mb/d to 102 mb/d, which would be a record high. This projection may prove elusive as tighter monetary policy curbs oil consumption in the West, notably the U.S. and Europe.

It's difficult to imagine **OPEC+** simply standing pat if the expected pickup in global oil demand falters and prices slide further, especially given how aggressively it has scaled back production since the initial pandemic shock. We view the current US$65-70/bbl range as being critical for the cartel, particularly Saudi Arabia. Sustained prices around this level would undermine the kingdom's budget, pushing it into deficit. We suspect that Riyadh is currently in wait-and-see mode until it obtains greater clarity on the impact of Western sanctions on Russian exports of crude and refined products. At least for this month, Moscow has stated it will cut output by 500 kb/d, but it could be forced to do more. In addition, the cartel likely wants to see how the global inflation picture evolves before deciding to tighten output in an effort to reignite prices.

Key Takeaway: While it's probably not time to push the panic button yet, the oil market is likely going to remain on shaky ground for the rest of the year. This explains why we had already revised our 2023 projection for WTI down to $85/bbl (from $90) just prior to the banking fallout. Events over the last week underscore that risks are still tilted to the downside.

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*Indications of stronger growth and a move toward price stability are **good news** for the economy.*

	Good News	Bad News
Canada ▪ GoC yields plunge amid global financial market turmoil ▪ Housing market activity shows some signs of bottoming	**Existing Home Sales** +2.3% (Feb.) **Housing Starts** +12.7% to 243,959 a.r. (Feb.) **Household Debt-to-Income Ratio** -3.9 ppts to 180.5% (Q4) **Manufacturing Sales Volumes** +3.8% (Jan.) **Wholesale Trade Volumes** +2.0% (Jan.) **Construction Investment** +1.5% (Jan.) **Industrial Product Prices** slowed to +1.4% y/y; **Raw Materials Prices** -5.2% y/y (Feb.)	**MLS Home Prices** -1.1% (Feb.) **Global Investors** bought $4.2 bln in Canadian securities (Jan.)—much lower than the prior month
United States ▪ Banking sector turmoil worst since GFC ▪ S&P 500, Nasdaq poised to end week higher despite heightened volatility ▪ Treasury yields drop	**Consumer Prices** eased to +0.4% (Feb.)—but **supercore** ticked up to +0.5% **Producer Prices** -0.1%; **Import Prices** -0.1% (Feb.) **Housing Starts** +9.8% to 1.450 mln a.r. (Feb.) **Building Permits** +13.8% to 1.524 mln a.r. (Feb.) **NAHB Housing Market Index** +2 pts to 44 (Mar.) **Jobless Claims** -20k to 192k (March 11 week) **NFIB Small Business Optimism** +0.6 pts to 90.9 (Feb.)	**Retail Sales** -0.4% (Feb.) **Industrial Production** unch (Feb.)—**and Capacity Utilization** steady at 78.0% **U of M Consumer Sentiment** -3.6 pts to 63.4 (Mar. P)—first decline in four months **Empire State Manufacturing Survey** -3.8 pts to 44.5; **Philly Fed Index** -9.2 to 39.4 (Mar.)—both ISM-adjusted **Global Investors** bought a net $31.7 bln in U.S. securities (Feb.)—vs. $103.3 bln in the prior month **Leading Index** -0.3% (Feb.)
China ▪ PBoC cuts RRR to support lending	**Industrial Production** +2.4% y/y (Jan.-to-Feb.) **Retail Sales** +3.5% y/y (Jan.-to-Feb.) **Fixed Asset Investment** +5.5% y/y (Jan.-to-Feb.)	
Japan ▪ Yen strengthens amid flight to safety	**Exports** +6.5% y/y; **Imports** +8.3% y/y (Feb.) **Core Machine Orders** +9.5% (Jan.)	**Industrial Production** revised lower to -5.3% (Jan.)
Europe ▪ ECB hikes 50 bps as expected; future moves will be data-dependent ▪ Credit Suisse gets lifeline from SNB ▪ U.K. budget focusses on enticing more people into the labour force	**Euro Area—Industrial Production** +0.7% (Jan.) **U.K.—Payrolls** +98,000 (Feb.)—above expected **U.K.—Employment** +65,000 (3 mths to Jan.) **U.K.—Jobless Rate** steady at 3.7% (3 mths to Jan.)	**Euro Area—Labour Costs** +5.7% y/y (Q4) **Italy—Industrial Production** -0.7% (Jan.) **U.K.—Average Weekly Earnings (ex. Bonus)** +6.5% y/y (3 mths to Jan.)
Other ▪ WTI tumbles below $70 on market angst	**Australia—Employment** +64,600 (Feb.) **Australia—Jobless Rate** -0.2 ppts to 3.5% (Feb.)	**Australia—Westpac Consumer Confidence** unch (Mar.) **Australia—NAB Business Confidence** -10 pts to -4 (Feb.) **Australia—CB Household Spending** -0.1% (Feb.)

Services Demand: The Third Leg of Resiliency

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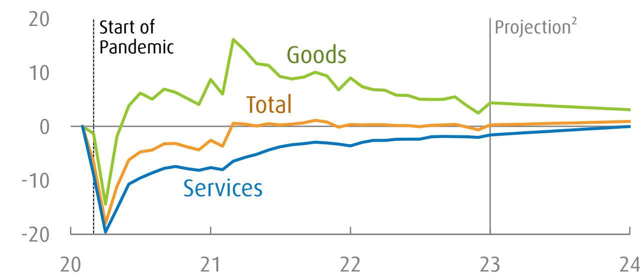
While the financial sector is under stress from the Fed's fierce tightening campaign, the broader economy's muffled response to date is one reason inflation remains elevated. Recent *Focus* articles discussed two factors buffering the economy from tighter policy: excess savings and strong job growth [1]. But there's a third pillar as well: the unleashing of **deferred services spending**. This begs the question: **how much bottled-up demand exists**?

On the surface, there appears to be little unfulfilled aggregate demand left. Due to massive stimulus cheques, by March 2021 real consumer spending had returned to the trend it would have been on had it continued to grow at the average 5-year rate before the pandemic (*Chart 1*). Since then, total spending has largely held to the pre-pandemic trend, as robust growth in services (more than double the norm) countered a decline in goods. However, services were still 1.6% below trend as of January 2023. Assuming they continue to rise at the rate of the past six months, some **pent-up demand could last through 2023**. And, if goods spending holds steady as households deplete extra savings, total consumption could rise modestly versus trend by year-end.

A look under the hood reveals some notable moves within major sub-groups. (*Table 1*). In the first two years of the pandemic, demand for **durable goods** soared as households borrowed at rock-bottom rates and were restricted from (or fearful of) attending in-person events. Leading the pack are books (*Chart 2*), musical instruments, and recreational goods and vehicles. By contrast, an initial rush to buy furniture and appliances quickly faded as the housing market slumped and credit costs soared. Used vehicles were held back by lean supplies and spiraling prices. However, spending on new vehicles was much stronger than suggested by unit vehicle sales, reflecting a shift toward purchases of more profitable (and more available) high-end light trucks and electric vehicles.

Among **nondurable goods**, clothing picked up its socks after an initial stumble, despite the slow return of workers to the office (at 50% of pre-pandemic occupancy

Chart 1
Services Lagging
United States (% difference from trend growth)
Real Consumer Spending vs. Pre-Pandemic Trend[1]



[1] trend based on 5-year average of m/m % change to February 2020;
[2] projection based on 6-month average of m/m % change to January 2023
Sources: BMO Economics, Haver Analytics

Table 1
Real PCE vs. Pre-Pandemic Trend[1]
United States — Jan. 2023 (% difference from trend growth)

Total	+0.3
Goods	+4.4
Services	-1.6
Durable Goods	+7.3
Recreational books	+30.7
Musical instruments	+17.2
New motor vehicles	+12.7
Recreational goods and vehicles	+11.3
Furnishings and household equipment	-3.7
Used motor vehicles	-7.2
Nondurable Goods	+2.3
Clothing and footwear	+13.9
Gasoline and other energy goods	-2.6
Food and beverages for off-premises consumption	-3.1
Eggs	-46.9
Services	-1.6
Spectator sports	+31.4
Financial services	+12.6
Insurance	+6.3
Food services	+4.4
Accommodation	+2.8
Air transportation	+2.3
Professional and other services	-3.6
Recreation services	-5.9
Health care	-6.3
Public ground transportation	-12.6
Live entertainment excluding sports	-20.0
Personal care	-24.9
Motor vehicle rental	-40.0
Film theatres	-67.6

[1] trend based on 5-year average of m/m % change to February 2020
Sources: BMO Economics, Haver Analytics

based on average Kastle card swipes in ten U.S. cities). By contrast, fewer commuters and more expensive gasoline held back fuel consumption, while soaring food prices took a bite out of groceries. Notably, egg consumption cracked after prices spiked 70% y/y due to the avian flu's crippling effect on hen supply. While food inflation has moderated, prices are likely to stay high due to the severe drought across much of the country.

The **service** sector, which accounts for two-thirds of personal consumption, needs to make up ground. Spending at the cinema has flopped, still two-thirds below trend and no encore in sight due to streaming services (*Chart 3*). Enduring behavioural changes and health concerns likely also explain softer demand for personal care services and live entertainment (excluding sports). Public transportation continues to lag due to remote working. Soaring costs and limited supplies of motor vehicles have dented auto rentals. Bucking the trend is strong demand for spectator sports—apparently fans are loyal to teams and players that can throw, kick or hit a ball or shoot a puck with pin-point accuracy (*Chart 4*). Also tracking higher are indoor dining, hotels and air travel, with airline executives citing continued strong demand.

The **Fed's problem** is that interest rates have less effect on services than on goods, which are more likely to be financed. Robust spending on labour-intensive activities is propelling employment, wages and prices higher. The leisure and hospitality sector continues to punch well above its weight in creating jobs. This means the Fed might need to clamp down harder on loan costs. But note that discretionary services could be the first item on the chopping block if the economy slips into recession. That would at least help dampen inflation.

Bottom Line: The consumer's desire to catch up on deferred services could support the economy through year-end, delaying or even averting a recession. But, as per the other two buffers—excess savings and a strong job market—the economy risks a harder landing if inflation stays sticky or recent financial stress persists.

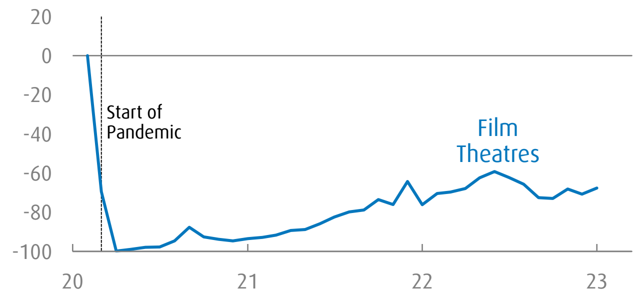
Chart 2
Bestseller

United States (% difference from trend growth)
Real Consumer Spending vs. Pre-Pandemic Trend[1]

[1] trend based on 5-year average of m/m % change to February 2020
Sources: BMO Economics, Haver Analytics

Chart 3
Lights Out

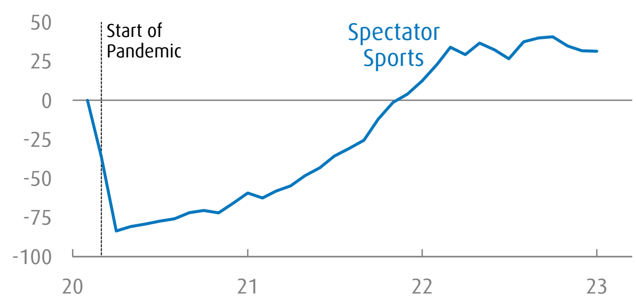
United States (% difference from trend growth)
Real Consumer Spending vs. Pre-Pandemic Trend[1]



[1] trend based on 5-year average of m/m % change to February 2020
Sources: BMO Economics, Haver Analytics

Chart 4
***Fan**ning Demand*

United States (% difference from trend growth)
Real Consumer Spending vs. Pre-Pandemic Trend[1]



[1] trend based on 5-year average of m/m % change to February 2020
Sources: BMO Economics, Haver Analytics

Endnote:

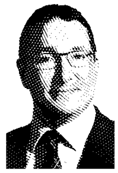
[1] Can Surplus Savings Save the Expansion? Focus February 17, 2023. Why Is Employment Still So Strong? Focus January 20, 2023. [^]

Economic Forecast Summary for March 17, 2023

	2022				2023				Annual		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	2022	2023	2024
CANADA											
Real GDP (q/q % chng : a.r.)	2.4	3.6	2.3	0.0	1.0	-0.5	-0.7	1.0	3.4	0.7	1.3
Consumer Price Index (y/y % chng)	5.8	7.5	7.2	6.7	5.5	3.8	3.5	3.1	6.8	4.0	2.5
Unemployment Rate (percent)	5.7	5.1	5.1	5.1	5.0	5.3	5.6	5.8	5.3	5.4	5.6
Housing Starts (000s : a.r.)	241	271	281	259	235 ↑	242	225	220	263	230	220
Current Account Balance ($blns : a.r.)	11.0	22.0	-33.7	-42.6	-36.4 ↓	-36.6 ↓	-42.5 ↓	-44.5 ↓	-10.8	-40.0 ↓	-45.0 ↓
Interest Rates	(average for the quarter : %)										
Overnight Rate	0.33	1.17	2.75	3.92	4.50	4.50	4.50	4.50	2.04	4.50	3.88
3-month Treasury Bill	0.39	1.43	2.91	3.96	4.40	4.45 ↓	4.45 ↓	4.45 ↓	2.17	4.45	3.85
10-year Bond	1.92	2.98	3.01	3.16	3.00 ↓	3.25 ↓	3.20 ↓	3.05	2.77	3.15 ↓	2.95
Canada-U.S. Interest Rate Spreads	(average for the quarter : bps)										
90-day	9	33	16	-22	-39 ↓	-55 ↓	-60 ↓	-60 ↓	9	-54 ↓	-52 ↓
10-year	-2	5	-10	-67	-63 ↓	-67 ↓	-60 ↓	-52 ↓	-18	-60 ↓	-44
UNITED STATES											
Real GDP (q/q % chng : a.r.)	-1.6	-0.6	3.2	2.7	0.5	-1.0	-1.0	0.8	2.1	0.7	1.3
Consumer Price Index (y/y % chng)	8.0	8.6	8.3	7.1	5.9	4.5	4.0	3.7	8.0	4.5	2.5
Unemployment Rate (percent)	3.8	3.6	3.5	3.6	3.5	4.0	4.6	4.8	3.6	4.2	4.7
Housing Starts (mlns : a.r.)	1.72	1.65	1.45	1.40	1.40 ↑	1.38 ↑	1.34	1.37	1.55	1.37 ↑	1.41
Current Account Balance ($trlns : a.r.)	-1.13	-0.95	-0.87	-0.87	-0.86	-0.87	-0.87	-0.88	-0.95	-0.87	-0.88
Interest Rates	(average for the quarter : %)										
Fed Funds Target Rate	0.21	0.96	2.63	3.79	4.63	5.04	5.13	5.13	1.90	4.98	4.42
3-month Treasury Bill	0.30	1.10	2.75	4.18	4.80	5.00	5.05	5.05	2.08	5.00	4.35
10-year Note	1.94	2.93	3.10	3.83	3.65 ↓	3.90 ↓	3.80	3.55	2.95	3.75	3.40
EXCHANGE RATES	(average for the quarter)										
US¢/C$	79.0	78.4	76.6	73.7	73.9	73.8	75.1	76.5	76.9	74.8	77.7
C$/US$	1.27	1.28	1.31	1.36	1.35	1.35	1.33	1.31	1.30	1.34	1.29
¥/US$	116	130	138	141	133	134 ↑	132 ↑	131	131	132 ↑	127
US$/Euro	1.12	1.06	1.01	1.02	1.07	1.07	1.08	1.10	1.05	1.08	1.12
US$/£	1.34	1.26	1.18	1.17	1.21	1.21	1.23	1.24	1.24	1.22	1.27

Blocked areas mark BMO Capital Markets forecasts; up and down arrows (↑↓) indicate forecast changes; spreads may differ due to rounding

Canada



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Consumer Price Index

Tuesday, 8:30 am

Feb. (e)	**+0.5% (+0.1% sa)**	**+5.3% y/y**
Consensus	*+0.5%*	*+5.3% y/y*
Jan.	+0.5%	+5.9% y/y

CPI Core (% y/y)

	Trim	Median	ex. F&E
Feb. (e)	**+5.0**	**+4.9**	**+4.9**
Jan.	+5.1	+5.0	+4.9

Inflation likely cooled somewhat in February, with a small unseasonal 1% drop in gasoline prices providing a helping hand. Even so, there's still plenty of pressure on items throughout the CPI basket. Food prices will be in focus as they've been up an average of 0.8% per month over the past year, or more than 10% y/y. We're anticipating a more modest, but still historically beefy, increase that will likely keep the yearly rate in the double digits. Look for normal seasonal gains (February is usually strong) in other categories. The combination of a relatively modest monthly increase and favourable base effects (prices surged in February 2022), are expected to pull yearly **inflation** down six ticks to 5.3% y/y, a one-year low.

The yearly pace for the Bank of Canada's **core inflation** metrics (trim and median) are expected to slow about one tick. Unfortunately, it will likely take a greater deceleration for the 3-month annualized rates to hold steady. Flat or firmer short-term metrics won't be welcome news for policymakers, even if they continue to point to a slowing yearly rate. The more traditional core inflation metric, ex. food & energy, looks to hold steady at 4.9% y/y. While the recent global financial stress introduces new uncertainty, elevated inflation, a tight labour market, and a resilient economy suggest there's still some upside risk for policy rates despite markets pricing rate cuts by year-end.

Provincial Budgets

Quebec, New Brunswick
Tuesday
Saskatchewan
Wednesday
Ontario, Nova Scotia, Nfld. & Labr.
Thursday

Fiscal buffs will see six FY23/24 provincial budgets tabled in the span of three days. **Quebec** and **New Brunswick** are out on March 21st; **Saskatchewan** on March 22nd; and the trio of **Ontario**, **Nova Scotia** and **Newfoundland & Labrador** is due on March 23rd. With PEI headed for an election, this run will wrap up the spring budget season.

We have yet to see any major policy fireworks in the three documents tabled so far and the overall provincial fiscal picture is solid. Combined, the provinces are running back-to-back surpluses coming into this fiscal year, a feat we haven't seen since the pre-financial crisis period over a decade ago. That's a stunning turnaround from deep projected deficits, as FY22/23 revenues are now tracking more than $110 billion higher than projected at the time of the 2021 budgets. Simply put, the stronger economic rebound and much higher-than-expected inflation (and therefore nominal growth) have been an absolute boon for revenues. Now, however, the extremely low expectations bar has been adjusted much higher and the easy upside surprises of the past two years look to be behind us. Two of the three provinces to table budgets so far (B.C. and Alberta) have posted weaker projected balances for FY23/24 alongside cautious economic forecasts. Total borrowing should remain elevated and largely consistent with pre-COVID norms, but well below the outsized $149 billion program seen at the height of the pandemic in FY20/21.

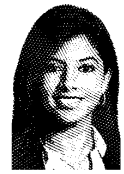
Retail Sales

Friday, 8:30 am

		Ex. Autos
Jan. (e)	**+1.5%**	**+0.8%**
Consensus	*+0.7%*	*+0.7%*
Dec.	+0.5%	-0.6%

Retail sales look to post a solid gain in January, consistent with broader economic strength to start the year. We look for a 1.5% increase, larger than StatCan's flash estimate of +0.7%. The headline rise was likely boosted by auto sales and higher gas prices, and we expect the latter resulted in sales ex-autos posting a sizeable 0.8% increase. Meantime, higher goods prices suggest that sales in volume terms will be softer than the headline.

United States



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Existing Home Sales

Tuesday, 10:00 am

Feb. (e)	**4.10 mln a.r. (+2.5%)**
Consensus	*4.20 mln a.r. (+5.0%)*
Jan.	4.00 mln a.r. (-0.7%)

Existing home sales look to rebound 2.5% to 4.1 mln annualized in February, halting the longest stretch of declines on record. Pending home sales popped in January after rising in December for the first time in thirteen months, so a bounce-back is due. Looking ahead, we could soon see a bottom for existing home sales after sliding to the lowest level since 2010. The end of the Fed's aggressive rate-hike campaign is getting closer, while the job market remains sturdy. Meantime, mortgage rates, although still elevated, have continued to hold below last November's more-than-two-decade high. Still, sales will remain low this year if the economy slips into a mild recession.

FOMC Announcement and Summary of Economic Projections

Wednesday, 2:00 pm
Press briefing at 2:30 pm

See Michael Gregory's Thought on page 4.

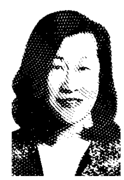
Durable Goods Orders

Friday, 8:30 am

	Durable Orders	Core Orders
Feb. (e)	**+2.5%**	**-0.2%**
Consensus	*+1.5%*	*unch*
Jan.	-4.5%	+0.8%

Durable goods orders likely climbed 2.5% in February, mainly owing to Boeing bookings that took flight on one particularly large order. Meantime, core capital goods orders should decline following a 0.8% rise in January. And, the control measure of shipments, an input for GDP, could fall again, flagging Q1 weakness in capital spending. Looking ahead, durable goods orders will likely wax and wane, ending the year lower as manufacturing continues to face major headwinds.

Central Banks



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BoE Monetary Policy Announcement

Thursday, 8:00 am ET
Press briefing to follow

The **BoE** will make its announcement on Thursday amid a volatile financial backdrop and following a (thankfully) calmer Spring Budget. In our view, the majority of the Monetary Policy Committee will continue to press for another rate hike, but **moderate the pace to 25 bps**, bringing its Bank Rate to a 14½-year high of 4.25%. This would be the eleventh hike in a row, but the slowest since last summer. Before the recent market chaos, this was not expected to be an easy decision, given that there is plenty of discourse within the Committee. In December, the vote was split 3 ways (one voted for a 75 bp hike, 6 for 50, and 2 for no change); then, in February, the vote was split 2 ways (7 voted for 50, and 2 voted for no change). Now, the majority will likely be more willing to slow things down a bit, even as the recent economic data have beaten expectations and shown improvement in activity. Plus, there seems to be more support behind the view that there is a lag to when rate hikes show up in the economy. The Bank can always add on more rate increases if needed, and adopt a slow and steady hiking pace. But for now, it is probably best not to upset the apple cart during these uncertain times.

Financial Markets Update for March 17, 2023

		Mar 17 [1]	Mar 10	Week Ago	4 Weeks Ago	Dec 31, 2022
					(basis point change)	
Canadian	Call Money	4.50	4.50	0	0	25
Money Market	Prime Rate	6.70	6.70	0	0	25
U.S. Money	Fed Funds (effective)	4.75	4.75	0	0	25
Market	Prime Rate	7.75	7.75	0	0	25
3-Month Rates	Canada	4.37	4.46	-9	-13	14
	United States	4.44	4.87	-43	-34	10
	Japan	-0.27	-0.19	-7	-10	-9
	United Kingdom	4.09	4.34	-25	-11	22
	Australia	3.69	3.63	6	22	42
2-Year Bonds	Canada	3.60	3.95	-36	-55	-45
	United States	3.95	4.59	-64	-67	-48
10-Year Bonds	Canada	2.76	2.99	-23	-53	-54
	United States	3.40	3.70	-30	-42	-48
	Japan	0.27	0.40	-13	-23	-14
	Germany	2.08	2.50	-42	-36	-48
	United Kingdom	3.21	3.64	-43	-30	-45
	Australia	3.39	3.58	-19	-43	-66
Risk Indicators	VIX	24.8	24.8	0.0 pts	4.8 pts	3.2 pts
	Inv. Grade CDS Spread [2]	84	81	3	10	2
	High Yield CDS Spread [2]	507	489	19	54	23
					(percent change)	
Currencies	US¢/C$	72.66	72.30	0.5	-2.1	-1.5
	C$/US$	1.376	1.383	—	—	—
	¥/US$	132.06	135.03	-2.2	-1.6	0.7
	US$/€	1.0631	1.0643	-0.1	-0.6	-0.7
	US$/£	1.214	1.203	0.9	0.9	0.5
	US¢/A$	66.84	65.80	1.6	-2.8	-1.9
Commodities	CRB Futures Index	256.65	264.99	-3.2	-4.1	-7.6
	Oil (generic contract)	66.40	76.68	-13.4	-13.0	-17.3
	Natural Gas (generic contract)	2.38	2.43	-2.2	4.4	-46.9
	Gold (spot price)	1,962.82	1,868.26	5.1	6.5	7.6
Equities	S&P/TSX Composite	19,317	19,775	-2.3	-5.8	-0.4
	S&P 500	3,917	3,862	1.4	-4.0	2.0
	Nasdaq	11,604	11,139	4.2	-1.6	10.9
	Dow Jones Industrial	31,789	31,910	-0.4	-6.0	-4.1
	Nikkei	27,334	28,144	-2.9	-0.7	4.7
	Frankfurt DAX	14,730	15,428	-4.5	-4.9	5.8
	London FT100	7,322	7,748	-5.5	-8.5	-1.7
	France CAC40	6,914	7,221	-4.2	-5.9	6.8
	S&P ASX 200	6,995	7,145	-2.1	-4.8	-0.6

[1] = as of 11:05 am *[2] = One day delay*

	Monday March 20	Tuesday March 21	Wednesday March 22	Thursday March 23	Friday March 24
Japan	**BoJ Summary of Opinions from Mar. 9-10 meeting**	**Markets closed**	**Machine Tool Orders** **Feb. F (e) -10.7% y/y** Jan. -9.7% y/y	**Department Store Sales** **Feb.** Jan. +15.1% y/y	**CPI / Core CPI** **Feb. (e) +3.3% y/y +3.1% y/y** Jan. +4.3% y/y +4.2% y/y **CPI ex. Food & Energy** **Feb. (e) +3.4% y/y** Jan. +3.2% y/y **Manufacturing PMI** **Mar. P** Feb. 47.7 **Services PMI** **Mar. P** Feb. 54.0
Europe	**EURO AREA** **Trade Deficit** **Jan.** Dec. €18.1 bln **GERMANY** **Producer Price Index** **Feb. (e) -1.4% +14.4% y/y** Jan. -1.0% +17.8% y/y **UNITED KINGDOM** **Rightmove House Prices** **Mar.** Feb. unch 3.6% y/y	**GERMANY** **ZEW Survey—Expectations** **Mar. (e) 15.0** Feb. 28.1 **FRANCE** **Retail Sales** **Feb.** Jan. -2.6% y/y	**UNITED KINGDOM** **Consumer Price Index** **Feb. (e) +0.6% +9.8% y/y** Jan. -0.6% +10.1% y/y **Core CPI** **Feb. (e) +5.7% y/y** Jan. +5.8% y/y **Producer Price Index (Output)** **Feb. (e) +0.1% +12.4% y/y** Jan. +0.5% +13.5% y/y	**EURO AREA** **Consumer Confidence** **Mar. P (e) -18.4** Feb. -19.0 **UNITED KINGDOM** **8:00 am ET BoE Monetary Policy Announcement**	**EURO AREA** **Manufacturing PMI** **Mar. P (e) 49.0** Feb. 48.5 **Services PMI** **Mar. P (e) 52.5** Feb. 52.7 **UNITED KINGDOM** **GfK Consumer Confidence** **Mar. (e) -36** Feb. -38 **Retail Sales (incl. Fuel)** **Feb. (e) +0.2% -4.8% y/y** Jan. +0.5% -5.1% y/y **Manufacturing PMI** **Mar. P (e) 49.8** Feb. 49.3 **Services PMI** **Mar. P (e) 53.0** Feb. 53.5
Other		**AUSTRALIA** **RBA Minutes from Mar. 7 meeting**		**BRAZIL** **Bank of Brazil Monetary Policy Meeting**	

D = date approximate

Upcoming Policy Meetings | Bank of England: May 11, June 22, Aug. 3 | European Central Bank: May 4, June 15, July 27

Canada

Monday March 20

8:30 am	**New Motor Vehicle Sales**	
Jan. (e)	**+8.5% y/y**	
Dec.	+7.1% y/y	
Noon	5-year bond auction $3.5 bln	

Tuesday March 21

8:30 am	**Consumer Price Index**	
Feb. (e)	**+0.5% (+0.1% sa)**	**+5.3% y/y**
Consensus	*+0.5%*	*+5.3% y/y*
Jan.	+0.5%	+5.9% y/y

8:30 am	**CPI Core (% y/y)**		
	Trim	**Median**	**ex. F&E**
Feb. (e)	**+5.0**	**+4.9**	**+4.9**
Jan.	+5.1	+5.0	+4.9

Quebec Budget

New Brunswick Budget

11:15 am — Cash management bond buybacks $0.5 bln

Wednesday March 22

8:30 am	**New Housing Price Index**	
Feb. (e)	**unch**	**+1.6% y/y**
Jan.	-0.2%	+2.7% y/y

8:30 am	**Household Credit**	**Mortgage Credit**
Jan.		
Dec.	+6.1% y/y	+7.0% y/y

8:30 am — **National Population Estimates (Q4)**

1:30 pm — **BoC Summary of Deliberations for the Mar. 8 decision**

Saskatchewan Budget

Thursday March 23

Ontario Budget

Nova Scotia Budget

Newfoundland & Labrador Budget

U.S. President Biden visits Canada (March 23-24)

30-year bond auction announcement

Friday March 24

8:30 am	**Retail Sales**	**Ex. Autos**
Jan. (e)	**+1.5%**	**+0.8%**
Consensus	*+0.7%*	*+0.7%*
Dec.	+0.5%	-0.6%

8:30 am	**Manufacturing Sales**
Feb. A	
Jan.	+4.1%
8:30 am	**Wholesale Trade**
Feb. A	
Jan.	+2.4%

United States

Monday March 20

11:30 am — 13- & 26-week bill auctions $105 bln

Tuesday March 21

10:00 am	**Existing Home Sales**
Feb. (e)	**4.10 mln a.r. (+2.5%)**
Consensus	*4.20 mln a.r. (+5.0%)*
Jan.	4.00 mln a.r. (-0.7%)

FOMC Meeting begins

11:00 am — 4-, 8- & 17-week bill auction announcements

11:30 am — 52-week bill auction $34 bln

1:00 pm — 20[R]-year bond auction $12 bln

Wednesday March 22

7:00 am	**MBA Mortgage Apps**
Mar. 17	
Mar. 10	+6.5%

2:00 pm — **FOMC Announcement and Summary of Economic Projections**

2:30 pm — **Fed Chair Powell's Press Briefing**

11:30 am — 17-week bill auction

Thursday March 23

8:30 am	**Initial Claims**
Mar. 18 (e)	**200k (+8k)**[C]
Mar. 11	192k (-20k)
8:30 am	**Continuing Claims**
Mar. 11	
Mar. 4	1,684k (-29k)
8:30 am	**Chicago Fed National Activity Index**
Feb. (e)	**-0.05**
Jan.	0.23
8:30 am	**Current Account Deficit**
Q4 (e)	**$216.6 bln**
Consensus	*$213.6 bln*
Q3	$217.1 bln
10:00 am	**New Home Sales**
Feb. (e)	**640,000 a.r. (-4.5%)**
Consensus	*650,000 a.r. (-3.0%)*
Jan.	670,000 a.r. (+7.2%)
11:00 am	**Kansas City Fed Manufacturing Activity**
Mar. (e)	**-5**
Feb.	0

11:00 am — 13- & 26-week bill, 2-, 5- & 7-year note, 2[R]-year FRN auction announcements

11:30 am — 4- & 8-week bill auctions

1:00 pm — 10[R]-year TIPS auction $15 bln

Friday March 24

8:30 am	**Durable Orders**	**Core Orders**
Feb. (e)	**+2.5%**	**-0.2%**
Consensus	*+1.5%*	*unch*
Jan.	-4.5%	+0.8%

9:45 am — **S&P Global PMIs (Mar. P)**

10:00 am — **Revisions to Wholesale Inventories**

Fed Speaker: St. Louis' Bullard (9:30 am)

[C] = consensus [D] = date approximate [R] = reopening

Upcoming Policy Meetings | Bank of Canada: Apr. 12, June 7, July 12 | FOMC: May 2-3, June 13-14, July 25-26

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