Focus

BMO Economics
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How Do You Like Them Apples?

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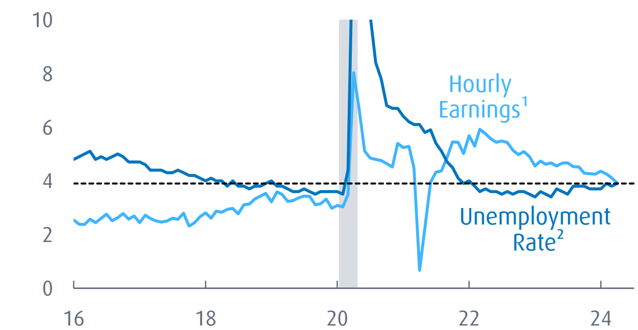
The 2024 tide of higher rates may have just turned. Financial markets enjoyed a rebound week, supported by a **non-hawkish Fed Chair**, a **rare downside surprise in U.S. jobs**, **calmer oil prices**, and an **upbeat earnings outlook** from heavyweight Apple. The FOMC meeting wasn't a massive market-mover, although Powell's reassurance that rate *hikes* were unlikely and a slightly larger-than-expected dampening of QT (to a $25 billion/month cap on Treasuries) were mildly helpful. But the April employment report really pushed on an opening door of lower yields, with payrolls rising just 175,000, the jobless rate ticking up to 3.9%, and average hourly earnings cooling to the slowest pace in nearly three years at 3.9% y/y. The latter two are both now a bit above their low-3% pre-pandemic level. **This is what a Fed lab-created soft-landing jobs report would look like.**

Chart 1
Meeting in the Middle
United States



Shading marks U.S. recession; [1] (y/y % chng); [2] (%)
Sources: BMO Economics, Bureau of Labor Statistics

The FOMC and jobs hogged the headlines, but it was a data-heavy week, with plenty of conflicting signals. For those who still fret about sticky inflation, there was a Q1 bounce in the important **employment cost index** (up 1.2% q/q, holding the yearly pace at 4.2%), strong February **home prices**, and an unnerving rise in the **prices** component of **both ISM** reports in April. Yet, on the flip side, there were arguably even more indicators that suggested the economy may finally be chilling after a strong run. Besides the high-profile jobs report**,** **job openings** and **quits** dropped in March, **consumer confidence** melted last month, and the **overall ISMs** both fell below the key 50 mark. Note that **in the 27-year history of the services ISM, the economy has almost always been in recession when below April's 49.4 reading**.

The net result of the wave of new info was to cut the **10-year yield** from its recent high of above 4.7% back down to around 4.5%. That's still well up from the sub-4% terrain at the start of the year, when thoughts of multiple Fed rate cuts were rife. In a similar vein, the **U.S. dollar** dipped roughly 1% this week, only partly reversing the 5% run-up in the first four months of the year. Equities took most of their cues from earnings, but milder yields supported a small rebound after April's 4.2% drop in the S&P 500 (its first setback in six months).

The key takeaway from the onslaught of new information this week was that **Fed rate cuts are back on the table for this year**, even if they're **not imminent**. We pushed back our call on the first move to September last week, fully recognizing the political awkwardness of the Fed cutting in the last FOMC before the November election. But that is now precisely where market pricing is also currently landing, and Chair Powell made another strong statement this week that the Fed will be guided by the economy and not politics in its coming rate decisions. We have pencilled in a second cut in December, and that, too, now roughly aligns with market pricing (by circumstance, not design).

The conventional wisdom is that the Fed will be mostly guided by the inflation data (true), and that they can only begin to cut when the trend in core cracks. But, given that Powell sees policy rates as plainly restrictive, and the job market appears to be softening somewhat, **some sustained weakness in growth could alone prompt them to begin loosening**—provided inflation stops deteriorating. The combination of even so-so inflation results and chillier growth could do the job. Given an unusual paucity of significant U.S. economic reports on deck for next week, we'll need to wait until mid-May for the next instalment in the rate cut saga. It's unlikely to deliver a clear-cut answer just yet, keeping the Fed in place for another quarter.

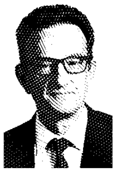
After **likening the Canadian economy to the Maple Leafs two weeks back** *(too harsh?),* the former has sagged while the latter have risen to the occasion. Following a surprisingly hearty start to 2024, Canadian growth has reverted to form, with GDP in the first two months of the year revised lower and March coming in flat. While the preliminary estimate for Q1 growth was thus pegged at 2.5% annualized (a touch below the BoC's 2.8% forecast), the subsequent weak March trade results suggest a slightly softer read—**we have trimmed our estimate two ticks to 2.3%**. The soft hand-off to Q2 points to a notably cooler 1% pace for the current quarter, and we continue to expect growth for the full year of 1.2%, or roughly half the U.S. growth rate.

The **dash of reality** for Canadian GDP, alongside the milder U.S. job growth, helped **reignite prospects for near-term Bank of Canada rate cuts**. While Governor Macklem was extraordinarily careful not to tip his timing hand at this week's dual testimonies, he did allow that rate cuts were getting closer and that the Bank could indeed deviate from the Fed—within limits. Said limits remain a mystery, but we'll stick with our view that the Bank can likely cut twice independent of the Fed, without causing undue strain on the currency.

The coming meeting on **June 5** is again seen as a **very real possibility for the first cut**, especially with the Fed potentially back in play in the summer. We have been calling for the BoC's rate-cutting cycle to begin in June since late last year, and we are doggedly sticking to that call. While we never want to hang a rate decision on a single indicator, the April CPI (on May 21) looms very large. Macklem has already signalled that the Bank expects inflation to stick close to the current 2.9% pace for a few months, due to a pop in gasoline prices (and we readily concur), but all eyes will be on whether core measures stay cool.

The Bank will also see **April jobs** (next Friday) and the **official Q1 GDP** results (May 31) before deciding on rates. But perhaps the second most important indicator tipping the Bank's decision will be the **U.S. CPI** (May 15). **Even if the BoC can go it alone, it sure would help if it appeared that U.S. cuts would soon follow.** So, like Leaf fans, we now look to the south for the next big result, and hope for the best.

Fed Policy: Hold Horizon Prolonging



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The **FOMC kept policy rates unchanged** on May 1, with the fed funds target range at a 23-year high of 5.25%-to-5.50%, which is where it has been since July. And the Fed signalled that the range **could remain here for many more months**.

The **policy statement** added the phrase: *"In recent months, there has been a lack of further progress toward the Committee's 2 percent inflation objective."* This stalling of progress was also acknowledged in the risk assessment, with the Fed no longer judging that *"the risks to achieving its employment and inflation goals are moving into better balance"*. Instead, the judgment is now that the risks *"have moved toward better balance over the past year"*. (The emphases are ours.) The statement also repeated the forward guidance that it won't be appropriate to reduce policy rates until the FOMC *"has gained greater confidence that inflation is moving sustainably toward 2 percent"*.

In the **press conference**, Chair Powell reiterated what he first mentioned on April 16: *"so far this year, the data have not given us that greater confidence"* and *"gaining such greater confidence will take longer than previously expected"*. In the meantime, the Fed was prepared to hold rates at current levels *"for as long as appropriate"* while still considering rate hikes to be *"unlikely"*.

And, as was the case at the mid-April event, absent in Powell's comments was the prior messaging (which had been employed as recently as April 3) that *"it will likely be appropriate to begin dialing back policy restraint at some point this year"*. The data have surprised so much to the high side that the Fed's confidence in its forecasts has eroded, making it harder to be even vague about the timing of rate cuts. Powell said we should *"see further progress on inflation this year. I don't know that it will be enough, sufficient [to trigger rate cuts], I don't know that it won't. I think we're going to have to let the data lead us on that."*

There is **still time for the data to lead**, and April's employment report was a step in the right direction. Payrolls expanded by 175k (a 6-month low), the jobless rate jumped a tenth to 3.9% (a 27-month high unrounded), and the yearly change in average hourly earnings slipped under 4% for the first time since June 2021. As such, **we still expect a couple of quarter-point rate cuts this year**. For example, between today and the September 18 policy announcement, there are four more employment reports and the same number of PCE inflation readings. And there are five CPI reports forthcoming.

Finally, as was signalled last meeting, the Fed announced changes to its **quantitative tightening** (QT) program. The monthly run-off cap for Treasuries was lowered to $25 bln from $60 bln beginning June 1st, with the (currently non-binding) MBS cap staying at $35 bln. When these latter payments ever get above the cap, they'll be reinvested in Treasuries. The tapering of Treasuries was a bit more than expected, likely reflecting the Fed's heightened sense of caution as QT starts getting more fully reflected in reserves reduction (so far, reduced overnight reverse repos have absorbed the brunt).

Bottom Line: Rate cuts are still many folds more probable than rate hikes. However, whether the Fed will judge that there has been sufficient disinflation progress made to start them by year-end has become more uncertain.

BoE: June or August?

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It's all about the mid-year mark; that is, for the **ECB** and the **BoE**. That's when both central banks are expected to pull the trigger on rate cuts, although the Fed's strong hints of a delayed cut are prompting some policymakers to second-guess themselves. How far can one diverge?

But we are not at the mid-year mark yet. The BoE is not expected to change policy on May 9. The decision, however, will not be a simple one given the wide range of views on the economic landscape and how to deal with it. On one extreme is **Swati Dhingra**, the dove who has voted to cut rates for the last two meetings, warning that waiting to do so will be costly. (**Chief Economist Huw Pill** takes the opposite view… there is a larger risk from easing too early.) The prior meeting in March saw the remaining eight members of the MPC voting to hold, but don't be fooled: three are in hawk's clothing. Example: **Jonathan Haskel** points to the ratio of job vacancies to unemployment, and how it is only coming down "*rather slowly*", which suggests inflation will stay persistent. **Megan Greene** warned that the job market is still tight and that wage and services price inflation are not consistent with a sustainable return to 2% inflation. Meantime, **Governor Andrew Bailey** seems comfortable with the idea of cutting rates ahead of the Fed. After all, he sees inflation "*moving in the right direction*"; and, while there is demand-led inflation in the U.S., it's more than what he is seeing in Britain.

So the question is when. The **labour market** is loosening up: the jobless rate is at a 6-month high of 4.2%; payrolls have been down for two consecutive months, a move not seen since 2020; and wages are growing at their slowest pace in 17 months. **Headline inflation** is at a 30-month low of 3.2%, and core CPI is at a 28-month low of 4.2%. Even services inflation is now at a 14-month low of 6.0%… still high, but progress is being made. Finally, note that grocery store price hikes hit a 30-month low of 3.2% in mid-April, and nonfood prices at grocers fell from year-ago levels for the first time since 2021. **We look for the BoE to ease this summer**… if not in June, then in August. Friday's GDP report will help guide the decision. The contraction in the second half of last year was short-lived and we look for 1.5% annualized GDP growth in Q1. Like Canada and China, it looks like there was a growth spurt at the start of the quarter (January) while February was a little less heated. A further slowing in March could add pressure on the BoE to begin easing sooner rather than later.

Recap

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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 ▪ BoC Governor Macklem: *"We're seeing what we need to see, but we need to see it for longer to be confident"* on inflation's progress	**Auto Sales** +14.0% y/y (Apr.) **Insolvencies** -0.6% y/y (Mar.)—first decline in two years	**Real GDP** +0.2% (Feb.)—below expected and March looks to be flat **Merchandise Trade Deficit** $2.3 bln (Mar.)—first shortfall in three months **Conference Board's Consumer Confidence Index** -8.5 pts to a 5-mth low of 59.3 (Apr.)
United States ▪ FOMC stays on hold, will start to slow the pace of balance sheet run-off on June 1 ▪ Fed Chair Powell says rate hikes are *"unlikely"* and still expects inflation to fall *"over the course of the year"*… but is less confident ▪ Cooler job data should lift Fed confidence somewhat	**Nonfarm Payrolls** +175,000 (Apr.)—**Jobless Rate** +0.1 ppts to 3.9%; **Average Hourly Earnings** +0.2% **Auto Sales** +2.8% to a 4-mth high of 16.00 mln a.r. (Apr.) **Job Openings** drop to a 3-year low of 8,488k (Mar.)—eases pressure on wages **UI Claims** unch at 208k (Apr. 27 week) **Goods & Services Trade Deficit** slipped to $69.4 bln (Mar.) **Factory Orders** +1.6% (Mar.)	**Employment Cost Index** +1.2% (Q1) **Nonfarm Productivity** +0.3% a.r. (Q1 P)—and **Unit Labour Costs** +4.7% a.r. **S&P CoreLogic Case-Shiller Home Price Index** +0.6%; **FHFA House Price Index** +1.2% (Feb.) **Conference Board's Consumer Confidence Index** -6.1 pts to a 21-mth low of 97.0 (Apr.) **Construction Spending** -0.2% (Mar.) **ISM Manufacturing PMI** -1.1 pts to 49.2 (Apr.)—prices paid at a 22-mth high **ISM Services PMI** -2.0 pts to a 16-mth low of 49.4 (Apr.)—prices paid at a 3-mth high
China ▪ PBoC to *"flexibly use policy tools"* to support economy	**Caixin Manufacturing PMI** +0.3 pts to a 14-mth high of 51.4 (Apr.)	**Industrial Profits** -3.5% y/y (Mar.) **Manufacturing PMI** -0.4 pts to 50.4; **Nonmanufacturing PMI** -1.8 pts to 51.2 (Apr.)
Japan ▪ JPY is best performing major currency this week after MoF intervenes 2x… swings from ¥160 to ¥152	**Industrial Production** +3.8% (Mar. P) **Jobless Rate** unch at 2.6% (Mar.)	**Retail Sales** -1.2% (Mar.)
Europe ▪ Euro Area recession… is over ▪ ECB officials continue to support June cut expectations… but not July ▪ Norges Bank on hold	**Euro Area—Real GDP** +0.3% (Q1 P)—generally above-expected growth in Germany, France, Italy and Spain **Euro Area—Consumer Price Index** steady at 2.4% y/y (Apr. P)—and **core CPI** slowed to 2.7% **Euro Area—Jobless Rate** unch at record-low 6.5% (Mar.)—and **Italy's** fell to a 15½-year low of 7.2% **Germany—Retail Sales Volumes** +1.8% (Mar.) **France—Consumer Spending** +0.4% (Mar.)	**Euro Area—Economic Confidence** -0.6 pts to a 2-mth low of 95.6 (Apr.) **Germany—Unemployment** +10,000 (Apr.) **France—Industrial Production** -0.3% (Mar.)
Other ▪ OECD lifts global growth outlook (thank you, U.S.A.) ▪ Mexico's economy losing momentum		**Australia—Private Sector Credit** +0.3% (Mar.) **Australia—Retail Sales** -0.4% (Mar.) **Australia—Trade Surplus** cut to A$5.0 bln (Mar.) **Mexico—Real GDP** slowed to +1.6% y/y (Q1 P)

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CRE Update: Out of Office

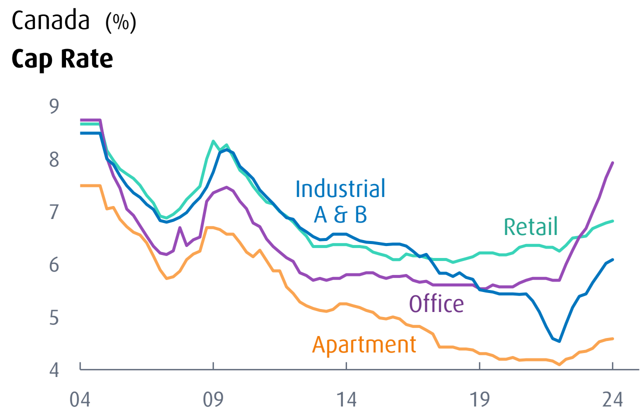
Highlights

- Following a pandemic-led surge in online spending, the **industrial** sector of commercial real estate has returned to more balanced conditions and should remain healthy as interest rates retreat and economic growth picks up in 2025. The segment outperformed in the past year amid substantial industrial-policy support for electric vehicles and batteries and, in the U.S., semiconductors, while Canada was assisted by a weak currency.
- Also topping expectations was Canada's **multifamily** segment as torrid population growth kept the market undersupplied. Multifamily will likely lead the CRE market this year, despite expected slower population growth, pressuring rents higher. By contrast, U.S. multifamily has softened due to earlier rampant apartment construction, though the high cost of home ownership will underpin rental demand.
- Canadian **retail** held up a little better than expected but insolvencies will likely continue to rise until interest-rate sensitive households see meaningful relief. By contrast, U.S. retailers will remain well-supported by sturdier consumers.
- The **office** segment is struggling with soaring vacancy rates amid sticky hybrid work patterns. Delinquency rates are likely to rise further until unneeded space is repurposed. Still, we won't see a repeat of the subprime mortgage crisis given the much smaller size of total office loans held by banks. As well, modern, top-tier office buildings with attractive amenities are likely to remain in high demand.

General Trends

CRE **capitalization rates** (which measure investment returns by comparing annual operating income to property prices) have risen about 1 ppt in Canada since the central bank began lifting rates in early 2022. The moderate increase relative to a sharper rise in 10-year Canada yields has kept the spread well below normal, indicating a mostly orderly downturn in the market. Cap rates rose across all four major CRE segments, though multifamily rates remain very low (*Chart 1*). U.S. cap rates have risen to above two-decade norms, led by a sinking office market. Investment rates of return for all four segments were negative in 2023 (*Chart 2*). Cap rates in both countries should rise moderately further this year, though lower interest rates will temper the increase.

Chart 1
Not Capped Out



Sources: BMO Economics, CBRE

After peaking in 2022, U.S. **commercial property prices** have fallen 21% to the lowest levels (outside the pandemic) since 2015 (*Chart 3*). Overall prices are down 7% y/y to March 2024, but, apart from offices, have steadied recently. Office property values have plunged 37% from their highs and 16% in the past year and look to fall further as owners with refinancing issues are forced to sell. Apartment building values are down 28% from peak levels, while industrial (-16%) and strip retail (-17%) have held up better, with the former still well above 2019 levels.

Delinquency rates for U.S. office CMBS have more than tripled since 2019 to 7.4% in April 2024, according to Trepp. By contrast, industrial (0.4%) and multi-family residential (1.3%) rates remain very low. Retail rates, though higher at 5.9%, have fallen in the past year. While U.S. bank CRE loan delinquency rates remain low at 1.2% in 2023Q4, they are expected to rise further (*Chart 4*). According to data firm MSCI, U.S. office buildings worth over $38 billion face some form of loan distress, the most in 14 years.

Although financial stress at some regional banks has subsided, **CRE loan exposure** remains a concern. Consequently, lenders have tightened credit standards and set aside substantial reserves to cover potential losses. CRE loans account for 17% of U.S. bank credit, with a lower ratio for large banks and higher exposure for smaller lenders. Office loans are a much smaller fraction of the total. Higher costs of borrowing and repairs have clashed with rent controls in some cities, notably Manhattan. Refinancing risks will remain elevated so long as interest rates and inflation stay high. Because of tumbling property prices, an estimated 44% of U.S. banks' office loans were underwater in late 2023, according to a study by the National Bureau of Economic Research.

Industrial

The U.S. industrial segment is **well supported** by the expanding warehouse and distribution needs of online commerce, as well as increased reshoring efforts to address supply-chain risks. Further support is provided by substantial government incentives to spur construction of facilities for electric vehicles, batteries and microchip production. Surging data demand to feed AI systems is driving construction of large data centres. However, the earlier boom in warehouse construction driven by retailers stocking up in the pandemic has led to record-high sublease space. Still, industrial availability and cap rates remain below normal, and rent increases, though slowing, are positive.

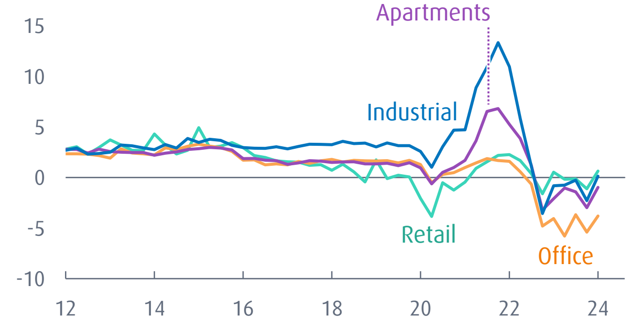
Canada's industrial segment **remains healthy but is settling down** amid new construction and less demand. The availability rate is near six-year highs of 3.7% in 2024Q1, but remains below its 15-year mean, finds CBRE. After two years of double-digit increases, rent growth has slowed to 0.9% y/y. Although average asking prices have decelerated, they are still rising, keeping cap rates low.

Industrial sector fundamentals should **remain healthy** in both countries as interest rates decline and economic growth picks up, with a low-valued currency also helping Canadian manufacturers. The main **risk** stems from a potential hard landing should interest rates stay high or wars in Ukraine and the Middle East escalate.

Chart 2
Negative Returns

United States (percent)

Total Quarterly Rate of Return on Real Estate

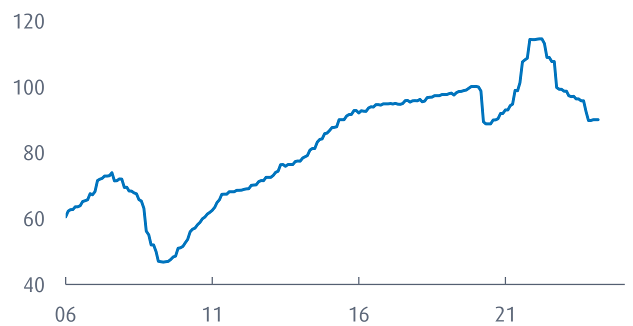


Sources: BMO Economics, Haver Analytics, NCREIF

Chart 3
Hitting Bottom?

United States (Feb. 2020 = 100)

Commercial Property Price Index — All Property

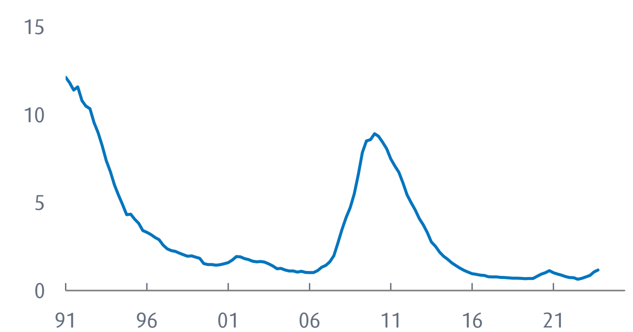


Sources: BMO Economics, Haver Analytics, Green Street Advisors

Chart 4
Still Surprisingly Low

United States — All Commercial Banks (% : end-of-period : s.a.)

Commercial Real Estate Loan Delinquency Rate



Sources: BMO Economics, Haver Analytics, FRB

Multifamily

Canada's multifamily residential market should remain well supported by a tight rental market, poor housing affordability, and an undersupply of purpose-built apartments. The CMHC's annual survey finds the national vacancy rate for rental apartments reached a new low of 1.5% in October 2023. Growth in average asking rents for residential properties was 8.8% y/y in March, says Rentals.ca. However, some relief may be in sight. The federal government's recent pledge to slash the number of non-permanent residents over three years could slow population growth from 3.2% y/y to a more normal 1%. The return of more sustainable household formation rates should allay pressure on supply, affordability, and rents. Greater Toronto is already dealing with swollen condo inventories, causing rents to decline modestly in the past year. And, more supply is on the way, as Toronto led all Canadian and U.S. cities with 221 construction cranes in 2024Q1 (versus 50 for runner-up Los Angeles). Still, strength in other regions should counter softness in the GTA.

Rental markets in the U.S. are generally less tight than in Canada due to slower population growth and an earlier surge in apartment construction to half-century highs. Apartment vacancy rates rose to 6.7% in March, just above 2019 levels. Rent growth continues to moderate from dizzying heights. After soaring almost 16% y/y in early 2022, Zillow's Observed Rent Index cooled to 3.6% in March, just below 2019 levels. Apartment List says the median rent on new apartment leases fell modestly in the past year to March. As a result, it's **cheaper to rent than own a home**, with average new mortgage payments 38% above average apartment rents in late 2023, finds CBRE. High ownership costs (including insurance and repairs) and a lean supply of resale properties have supported rental demand.

Retail

U.S. retailers are outperforming Canadian shops as less indebted households with longer-term fixed mortgages have more than offset slower population growth. Retail availability rates are below normal, as new store openings more than counter some high-profile closures (The Body Shop, Bed Bath and Beyond). Landlords are less inclined to discount rents today than in the pandemic with fewer percentage-of-sales deals. Shopping centre vacancy rates fell to 5.3% in 2023Q4, finds Cushman & Wakefield, the lowest since at least 2007. Average asking rents are nearly 17% above 2019 levels.

Canadian retail vacancy rates remain relatively low and cap rates have drifted just moderately higher. Strong population growth and continued demand for necessities have partly offset a pullback in discretionary spending. However, real consumer spending grew about half as fast in Canada as in the U.S. last year, and we expect it to grow by less than 1% in 2024. Retail insolvencies have surpassed 2019 levels and are likely to rise somewhat further as businesses repay pandemic-era government loans. While vacancy rates are still low in Toronto, Montreal, and Vancouver, they will likely rise modestly this year.

Winners and Losers: Retailers that rely on office commuters or face stiff competition from online and big box stores will remain challenged. Older department-store anchored malls should continue to lag open-air suburban shopping centres with ample amenities. Bifurcation driven by the rising cost-of-living may continue to benefit high-end and discount stores at the expense of mid-tier retailers. Stores that are quick to adopt AI systems to improve efficiency and customer service will gain an edge over laggards.

Office

Office landlords face rising defaults, distressed sales, and conversions as most companies are sticking with hybrid work patterns. In the U.S., **return-to-office rates have plateaued at around half of pre-pandemic levels**, finds Kastle Systems. Moreover, CBRE says that, due to vacations, sick leave and other away time, office occupancy averaged just 70% even before the pandemic, so the actual U.S. office occupancy rate today could be as low as 35%. That said, companies might still push for more in-person work out of concern for a long-term deterioration in corporate culture, collaboration and productivity. If return rates ultimately peak at say 60% of 2019 levels, office demand won't necessarily fall by 40% because companies will need extra space for amenities to draw back workers.

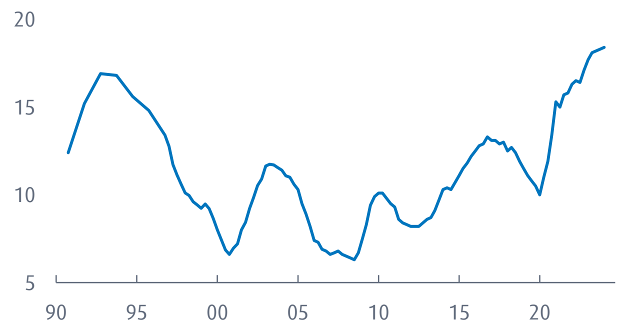
When the dust settles, **BMO Economics expects office demand to land about 20% below 2019 levels**, with downside risk.

Office vacancy rates hit a three-decade high of 18.6% in the U.S. in 2023Q4, according to CBRE. Despite a thriving AI industry, San Francisco's vacancy rate is at all-time highs of 36.7% versus under 4% in 2019. In Canada, vacancy rates reached record highs of 18.4% in 2024Q1 (*Chart 5*). However, net absorption turned positive, helped by the lowest construction since 2011 with no new office buildings breaking ground. Sublease space also fell for a third straight quarter. Greater Toronto's vacancy rate of 19.2% is now the highest since 1995. However, the city's office occupancy rate is up to about 60% of pre-COVID levels, according to the Strategic Regional Research Alliance, higher than nine major U.S. cities. Greater Vancouver has one of the lowest vacancy rates (9.5%) in North America, though it more than doubled since late 2019. In both countries, **office vacancy rates look to rise further this year** as leases turn over, before easing on less construction, more conversions and lower refinancing costs.

Chart 5
Nothing But Vacancy

Canada (%)

Office Vacancy Rate — All Classes



Sources: BMO Economics, CBRE

Surprisingly, **office rents have held relatively firm in the past year**. However, landlords are offering more perks, such as free parking, to keep tenants in place, and businesses will likely seek substantial savings when current leases expire (why pay for 5 days when you only need 3?). CoStar estimates that nearly half of current office leases were signed before the pandemic. Resigning will put increased pressure on struggling landlords to sell at distressed prices or default on loans. As new owners buy in at lower prices, they could cut rents and still earn a positive return, adding further strain on current landlords.

More unused office space will be **converted to mostly living and some warehouse space**. Avison Young estimates that 30% of Canadian office buildings could be converted to apartments or condos. So far, conversion activity remains low due to high costs, with CBRE noting that 13 projects initiated across Canada early this year have hardly reduced vacancy rates. Conversions will get a boost from the federal government's pledge to invest more than $1 billion to turn one-half of its office portfolio into a quarter million new housing units by 2031. The U.S. government is also supporting conversions by offering grants, loans, and tax incentives.

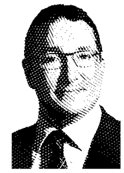
Winners and losers: Canada's office market should continue to outperform the U.S. given a higher level of well-capitalized institutional owners with long-run investment goals. However, a shrinking number of corporate head offices could weigh. Triple Class A buildings with modern amenities and energy efficiencies should perform better than older, lower-tier buildings in which landlords will need to retrofit and add amenities to stay competitive. Suburban office buildings may continue to outperform their downtown peers. CBRE says that the average U.S. downtown office vacancy rate surpassed that of the suburbs for the first time in decades in mid-2022. Canadian suburban office vacancy rates also remain lower than downtown rates. Office buildings in regions with weak population growth will remain vulnerable. Generative AI poses a longer-term risk should it displace workers in the financial, business services, and information sectors.

Economic Forecast Summary for May 3, 2024

		2023				2024				Annual		
		Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	2023	2024	2025
CANADA												
Real GDP	(q/q % chng : a.r.)	2.6	0.6	-0.5	1.0	2.3 ↓	1.0 ↑	1.5	2.0	1.1	1.2	2.0
Consumer Price Index	(y/y % chng)	5.1	3.5	3.7	3.2	2.8	3.0	2.4	2.5	3.9	2.7	2.2
Unemployment Rate	(percent)	5.1	5.3	5.5	5.8	5.9	6.3	6.5	6.6	5.4	6.3	6.0
Housing Starts	(000s : a.r.)	221	246	256	244	244	238	237	242	242	240	245
Current Account Balance	($blns : a.r.)	-18.6	-27.0	-19.0	-6.5	-27.0 ↓	-21.2 ↓	-23.4 ↓	-24.6 ↓	-17.8	-24.0 ↓	-25.0 ↓
Interest Rates		(average for the quarter : %)										
Overnight Rate		4.50	4.58	5.00	5.00	5.00	4.92	4.67	4.42	4.77	4.75	3.83
3-month Treasury Bill		4.39	4.54	5.02	5.01	4.94	4.85	4.60	4.40 ↑	4.74	4.70	3.80
10-year Bond		3.04	3.10	3.64	3.67	3.43	3.65	3.45	3.25	3.36	3.45	3.20
Canada-U.S. Interest Rate Spreads		(average for the quarter : bps)										
90-day		-39	-72	-52	-51	-52	-60 ↑	-82 ↑	-78 ↑	-53	-68 ↑	-74 ↑
10-year		-61	-50	-51	-77	-73	-84	-82	-81	-60	-80	-78
UNITED STATES												
Real GDP	(q/q % chng : a.r.)	2.2	2.1	4.9	3.4	1.6	1.7	1.4	1.6	2.5	2.4	1.8
Consumer Price Index	(y/y % chng)	5.7	4.0	3.6	3.2	3.2	3.4	3.0	3.0	4.1	3.2	2.3
Unemployment Rate	(percent)	3.5	3.6	3.7	3.8	3.8	3.9	4.1	4.2	3.6	4.0	4.1
Housing Starts	(mlns : a.r.)	1.39	1.45	1.37	1.48	1.42	1.43	1.45	1.46	1.42	1.44	1.48
Current Account Balance	($trlns : a.r.)	-0.85	-0.86	-0.79	-0.78	-0.86	-0.89	-0.90	-0.91	-0.82	-0.89	-0.94
Interest Rates		(average for the quarter : %)										
Fed Funds Target Rate		4.63	5.04	5.38	5.38	5.38	5.38	5.29	5.04	5.10	5.27	4.48
3-month Treasury Bill		4.78	5.27	5.54	5.52	5.45	5.45	5.45	5.15	5.28	5.35 ↓	4.55
10-year Note		3.65	3.59	4.15	4.44	4.16	4.45 ↓	4.25	4.05	3.96	4.25	3.95
EXCHANGE RATES		(average for the quarter)										
US¢/C$		74.0	74.5	74.6	73.5	74.2	73.3	74.0	74.7	74.1	74.0	76.0
C$/US$		1.35	1.34	1.34	1.36	1.35	1.36	1.35	1.34	1.35	1.35	1.32
¥/US$		132	137	145	148	149	153	152	150	140	151	147
US$/Euro		1.07	1.09	1.09	1.08	1.09	1.07	1.08	1.09	1.08	1.08	1.11
US$/£		1.22	1.25	1.27	1.24	1.27	1.26	1.27	1.28	1.24	1.27	1.29

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

Canada



Benjamin Reitzes
Canadian Rates & Macro Strategist
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Employment

Friday, 8:30 am

Apr. (e)	**+0.1% (+15,000)**
Consensus	*+0.1% (+17,500)*
Mar.	unch (-2,200)

Unemployment Rate

Apr. (e)	**6.2%**
Consensus	*6.2%*
Mar.	6.1%

Average Hourly Wages

Apr. (e)	**+5.1% y/y**
Mar.	+5.1% y/y

The unfriendly trend in the Canadian **labour market** likely persisted in April, as the economy continues to struggle under the weight of elevated interest rates. Population growth isn't likely to slow near-term, which means that anything short of about a 45k employment gain will push the jobless rate higher. Unfortunately, we're not expected to clear that hurdle for a seventh consecutive month, with a modest 15k job gain anticipated. The economy seems to have hit a wall in March, which was reflected in last month's modest job loss, and there's no reason to expect a meaningful improvement in April. Our call would push the jobless rate up another tick to 6.2%, the third consecutive monthly increase, and the highest level since 2017 (excluding the pandemic). We'll be watching hours worked closely, after the decline in March, to get an early read on Q2 GDP. — B.R.

United States

Sal Guatieri
Senior Economist
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Senior Loan Officer Opinion Survey (Apr.)

Monday, 2:00 pm

The Fed's quarterly **survey of loan officers** will likely show a further tightening of lending conditions and slowing in loan demand for businesses and households in April. The latest Beige Book noted that "*bank lending was roughly flat overall*", while the Dallas Fed's regional survey of loan officers reported weaker total credit demand in April amid restrictive standards. On a brighter note, the percentage of banks tightening standards peaked a year ago following a flareup in regional bank stress and amid heightened recession fears. The past couple of quarters have witnessed some moderation in this trend as concerns faded. Still, a high share of lenders is turning the screw on office loans. The diminished availability and high cost of credit will weigh on economic growth this year. — S.G.

Central Banks

BoE Monetary Policy Announcement and Report

Thursday, 7:00 am ET
Press briefing to follow

See Jennifer Lee's Thought on page 5.

Financial Markets Update for May 3, 2024

		May 3 [1]	Apr 26	Week Ago	4 Weeks Ago	Dec 31, 2023
					(basis point change)	
Canadian Money Market	Call Money	5.00	5.00	0	0	0
	Prime Rate	7.20	7.20	0	0	0
U.S. Money Market	Fed Funds (effective)	5.50	5.50	0	0	0
	Prime Rate	8.50	8.50	0	0	0
3-Month Rates	Canada	4.93	4.92	1	-2	-11
	United States	5.39	5.39	-1	3	6
	Japan	0.03	0.02	1	3	24
	United Kingdom	5.16	5.30	-14	-14	-16
	Australia	4.41	4.41	0	5	5
2-Year Bonds	Canada	4.17	4.32	-14	-4	29
	United States	4.81	5.00	-19	6	56
10-Year Bonds	Canada	3.66	3.82	-15	7	56
	United States	4.52	4.67	-14	12	64
	Japan	0.89	0.89	1	13	29
	Germany	2.51	2.57	-6	11	49
	United Kingdom	4.24	4.32	-9	17	71
	Australia	4.42	4.52	-10	32	46
Risk Indicators	VIX	14.1	15.0	-1.0 pts	-2.0 pts	1.6 pts
	Inv. Grade CDS Spread [2]	52	52	1	0	-4
	High Yield CDS Spread [2]	350	347	3	11	-7
					(percent change)	
Currencies	US¢/C$	73.07	73.15	-0.1	-0.7	-3.2
	C$/US$	1.369	1.367	—	—	—
	¥/US$	152.94	158.33	-3.4	0.9	8.4
	US$/€	1.0768	1.0693	0.7	-0.6	-2.5
	US$/£	1.255	1.249	0.5	-0.7	-1.4
	US¢/A$	66.10	65.33	1.2	0.5	-3.0
Commodities	CRB Futures Index	284.74	296.84	-4.1	-4.3	7.9
	Oil (generic contract)	78.44	83.85	-6.5	-9.7	9.5
	Natural Gas (generic contract)	2.06	1.92	7.1	15.4	-18.1
	Gold (spot price)	2,291.85	2,337.96	-2.0	-1.6	11.1
Equities	S&P/TSX Composite	21,909	21,969	-0.3	-1.6	4.5
	S&P 500	5,108	5,100	0.2	-1.8	7.1
	Nasdaq	16,110	15,928	1.1	-0.9	7.3
	Dow Jones Industrial	38,555	38,240	0.8	-0.9	2.3
	Nikkei	38,236	37,935	0.8	-1.9	14.3
	Frankfurt DAX	17,979	18,161	-1.0	-1.1	7.3
	London FT100	8,208	8,140	0.8	3.8	6.1
	France CAC40	7,958	8,088	-1.6	-1.3	5.5
	S&P ASX 200	7,629	7,576	0.7	-1.9	0.5

[1] = as of 11:10 am *[2] = One day delay*

	Monday May 6	Tuesday May 7	Wednesday May 8	Thursday May 9	Friday May 10
China	**Caixin Services PMI** — **Composite** **Apr. (e)** **52.5** **n.a.** Mar. 52.7 52.7 **Foreign Reserves** [D] **Apr.** Mar. $3.2 trln		**Trade Surplus** [D] **Apr. (e)** **$81.4 bln** Mar. $58.6 bln **Agg Yuan Financing (YTD)** [D] **Apr. (e)** **13.77 trln** Mar. 12.93 trln **New Yuan Loans (YTD)** [D] **Apr. (e)** **10.46 trln** Mar. 9.46 trln	**Current Account Surplus** [D] **Q1 P** Q4 $56.2 bln	**Consumer Prices** [D] **Apr. (e)** **+0.1% y/y** Mar. +0.1% y/y **Producer Prices** [D] **Apr. (e)** **-2.3% y/y** Mar. -2.8% y/y
Japan		**Services PMI** — **Composite** **Apr. F (e)** **54.6** **52.6** Mar. 54.1 51.7		**Real Cash Earnings** **Mar. (e)** **-1.5% y/y** Feb. -1.8% y/y **BoJ Summary of Opinions**	**Household Spending** **Mar. (e)** **-2.3% y/y** Feb. -0.5% y/y
Europe	**EURO AREA** **Services PMI** **Apr. F (e)** **52.9** Mar. 51.5 **Composite PMI** **Apr. F (e)** **51.4** Mar. 50.3 **Producer Price Index** **Mar. (e)** **-0.4%** **-7.7% y/y** Feb. -1.0% -8.3% y/y	**EURO AREA** **Retail Sales** **Mar. (e)** **+0.7%** **-0.2% y/y** Feb. -0.5% -0.7% y/y **GERMANY** **Factory Orders** **Mar. (e)** **+0.5%** **-0.7% y/y** Feb. +0.2% -10.6% y/y **Trade Surplus** **Mar. (e)** **€22.4 bln** Feb. €21.4 bln **FRANCE** **Trade Deficit** **Mar.** Feb. €5.2 bln	**GERMANY** **Industrial Production** **Mar. (e)** **-0.9%** **-3.5% y/y** Feb. +2.1% -4.9% y/y **ITALY** **Retail Sales** **Mar.** Feb. +0.1% +2.4% y/y **SWEDEN** **Riksbank Monetary Policy Meeting**	**UNITED KINGDOM** **7:00 am ET BoE Monetary Policy Announcement** **7:30 am ET BoE Press Conference** **DMP 1-Year CPI Expectations** **Apr. (e)** **+3.1%** Mar. +3.2%	**EURO AREA** **Minutes: ECB's Apr 11th Meeting** **UNITED KINGDOM** **Real GDP** **Q1 (e)** **+0.4%** **unch y/y** Q4 -0.3% -0.2% y/y **Monthly Real GDP** — **3m/3m** **Mar. (e)** **+0.1%** **n.a.** Feb. +0.1% +0.2% **Services Index** — **3m/3m** **Mar. (e)** **unch** **+0.4%** Feb. +0.1% +0.2% **Industrial Production** — **Mfg** **Mar. (e)** **-0.5%** **-0.5%** Feb. +1.1% +1.25 **Trade Deficit** **Mar. (e)** **£14.5 bln** Feb. £14.2 bln **ITALY** **Industrial Production** **Mar. (e)** **+0.3%** Feb. +0.1%
Other		**AUSTRALIA** **RBA Monetary Policy Announcement**	**BRAZIL** **Central Bank of Brazil's Monetary Policy Announcement**		

[D] = date approximate

Upcoming Policy Meetings | Bank of England: June 20, Aug. 1, Sep. 19 | European Central Bank: June 6, July 18, Sep. 12

North American Calendar — May 6–May 10

	Monday May 6	Tuesday May 7	Wednesday May 8	Thursday May 9	Friday May 10
Canada		**10:00 am Ivey PMI (s.a.)** **Apr.** Mar. 57.5 10:30 am 3-, 6- & 12-month bill auction $22.0 bln 11:15 am Cash management bond buybacks $0.5 bln 12:00 pm 1-month bill auction $2.5 bln	Noon 5-year bond auction $5.0 bln	**10:00 am BoC Financial System Review; Press Conference expected to follow**	**8:30 am Employment** **Apr. (e) +0.1% (+15,000)** *Consensus +0.1% (+17,500)* Mar. unch (-2,200) **8:30 am Unemployment Rate** **Apr. (e) 6.2%** *Consensus 6.2%* Mar. 6.1% **8:30 am Average Hourly Wages** **Apr. (e) +5.1% y/y** Mar. +5.1% y/y **10:30 am BoC Senior Loan Officer Survey (Q1)**
United States	**10:00 am Global Supply Chain Pressure Index** **Apr.** Mar. -0.27 **2:00 pm Senior Loan Officer Opinion Survey (Apr.)** Fed Speakers: Richmond's Barkin (12:50 pm); New York's Williams (1:00 pm) 11:30 am 13- & 26-week bill auctions $140 bln	**3:00 pm Consumer Credit** **Mar. (e) +$15.0 bln** *Consensus +$16.5 bln* Feb. +$14.1 bln Fed Speaker: Minneapolis' Kashkari (11:30 am) 11:00 am 4-, 8- & 17-week bill auction announcements 11:30 am 42-day cash management bill auction $75 bln 1:00 pm 3-year note auction $58 bln	**7:00 am MBA 30-year FRM** **May 3** Apr. 26 7.29% **10:00 am Wholesale Inventories** **Mar. F (e) -0.4%** Feb. +0.4% Fed Speakers: Vice Chair Jefferson (11:00 am); Boston's Collins (11:45 am); Governor Cook (1:30 pm) 11:30 am 17-week bill auction 1:00 pm 10-year note auction $42 bln	**8:30 am Initial Claims** **May 4 (e) 212k (+4k)** Apr. 27 208k (unch) **8:30 am Continuing Claims** **Apr. 27** Apr. 20 1,774k (unch) 11:00 am 13-, 26-, and 52-week bill auction announcements 11:30 am 4- & 8-week bill auctions 1:00 pm 30-year bond auction $25 bln	**10:00 am University of Michigan Consumer Sentiment** **May P (e) 75.0** *Consensus 76.8* Apr. 77.2 **2:00 pm Budget Balance** **Apr. '24** Apr. '23 +$176.2 bln Fed Speakers: Governor Bowman (9:00 am); Dallas' Logan (10:00 am); Chicago's Goolsbee (12:45 pm); Vice Chair for Supervision Barr (1:30 pm)

C = consensus; D = date approximate; R = reopening

Upcoming Policy Meetings | Bank of Canada: June 5, July 24, Sep. 4 | FOMC: June 11-12, July 30-31, Sep. 17-18

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