Focus

Feature Article

Extraordinary Population Delusions and the Trouble with Crowds

Our Thoughts

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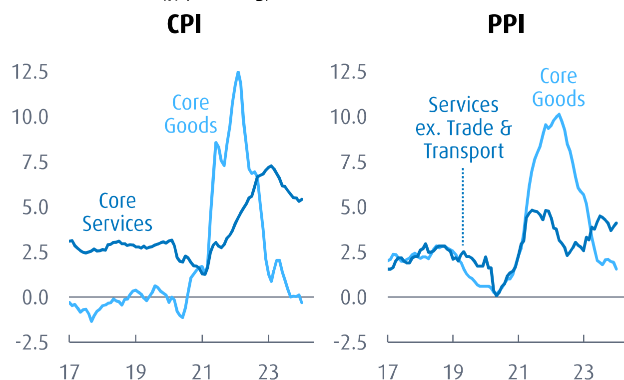
Neither Rain, Nor Snow, Nor CPI…

Douglas Porter, CFA
Chief Economist
douglas.porter@bmo.com

…shall keep the index from its appointed records. But perhaps PPI can. Ebullient equity markets contended with a series of challenging U.S. economic releases this week, including hotter-than-expected CPI and PPI readings, and surprising weakness in each of retail sales, industrial production and housing starts (all five for January). Even so, the **S&P 500** had still managed to reclaim a **new high** by Thursday's close, as had the **MSCI World Index**—which, admittedly, is not far from being a U.S. index these days. Brushing aside a short-lived downdraft following the CPI release, markets revved back up on a **healthy earnings backdrop** and were even enthused by the softness in retail sales, viewing it as keeping **Fed rate cut hopes** alive. Treasuries, too, had largely managed to shake off the post-CPI sell-off, in part due to a sudden run of soft growth indicators and reassuring Fedspeak.

Chart 1
U.S. Inflation: Now at Your Service



Sources: BMO Economics, Haver Analytics, BLS

However, the **surprisingly meaty PPI** revived lingering concerns that the **CPI** upturn was more than a seasonal spike. The report revealed a 0.8% rise in services excluding trade & transportation, the second largest monthly rise in over 14 years of records. While never a big fan of the PPI—*what does it really add to the CPI result?*—it's not a good look for an economy already grappling with sticky services inflation. The sting of the CPI had been partially dulled by the fact that the Fed targets the PCE deflator, and that measure has been much milder of late. **But the hefty PPI raised the risk that even the January PCE will come in hot** (due Feb. 29). Even if that's so, the **real test** will be whether the hearty inflation results spill over into **February**—then, we have a problem. Our assumption is that many firms are seizing on the calendar turn to hike prices, and January likely represents an outlier, not the start of a trend.

Still, Treasuries were further unsettled on net this week by the twin price reports, with **10-year yields** pushing above 4.3% for the first time since November, and up more than 50 bps from the late-2023 lows. In just the two weeks since the payrolls report, these yields have jumped more than 40 bps. It's been a bearish flattening move since then, with 2s up 45 bps and 5s surging almost 50 bps. Markets are steadily pushing Fed rate cuts later into the calendar, with now even the June meeting in some doubt. Back-to-back high-end price readings are not the stuff that will give the Fed confidence that inflation is on the right track. Suffice it to say that **we are comfortable with our call of a July start**. But pricing has shifted so markedly that our expectation of 100 bps of cumulative rate reductions this year is now a bit more than the market expects, so we have abruptly swung from being relative hawks to doves, without changing our view.

Canadian markets have had a broadly similar rethink, with **GoC yields** powering up by about 50 bps nearly across the curve as well from last December's lows. The local CPI will weigh in next Tuesday, and we expect it to be heavy. In seasonally adjusted terms, we look for at least a 0.3% rise, keeping the annual inflation rate at 3.4% (versus the U.S.drop to 3.1%). And, the BoC's cores are expected to nudge higher, not

lower. In contrast to some encouraging remarks by a variety of Fed speakers, **the Bank has stuck to a tougher message**, even as the Canadian economy is struggling more obviously with the higher interest rate environment. The reality is that with wages still chugging along at a 5% clip and productivity flailing, the Bank will have little confidence that services inflation will fade on its own.

Rumbling away in the background, **housing** is an ever-present source of concern for the Canadian inflation outlook. Having devoted much of his recent speech to the topic of persistent shelter inflation, Governor Macklem will have noted the signs of stirring in home sales in the past two months. The market has retightened to be roughly balanced in many cities, and the widespread consensus is that, amid pent-up demand and powerful demographic support, rate cuts could unleash activity. (Aside: Note that supply is categorically not riding to the rescue anytime soon. Starts have in fact ebbed to 240,000 units over the past year, versus 260,000 in the prior 12 months. Based on the current torrid growth in the adult population, the need is for at least 500,000 new units per year—stress on *"at least"*.) This coiled spring may be itself a strong reason to believe that the Bank will be exceptionally cautious in cutting rates.

Similar to pricing for the Fed, the market has steadily dialed back its views on BoC rate cuts in 2024. **Our call of a June start now looks a tad dovish**, although the market still has that meeting on the radar. But our cumulative cuts of 100 bps this year look positively perky versus a more subdued market expectation of 50-to-75 bps. There is still plenty of data to flow under the bridge, but it does appear that the risks lie to the low side of our call for cuts this year, with employment hanging in, housing showing a pulse and core inflation sticky.

Finally, while the Canadian economy is struggling to grow, it's not obviously rolling over; construction, manufacturing and wholesale trade were all close to flat in volume terms in December, suggesting that GDP is still just holding its head above water. The most recent consensus survey (conducted just this week) revealed a small pick-up in growth expectations for 2024, albeit to a very modest 0.6% (we and the BoC are at 0.8%). While that's paltry stacked up against 3%+ population growth, at least it's still positive.

Best. Recession. Ever. Japan's GDP did *not* manage to stay positive in the second half of last year, prompting a flood of headlines declaring the world's fourth largest economy to be "*in recession*". Yet, this is a classic example of how two quarters of negative GDP do not necessarily equal recession. (And for the umpteenth time, it is a rough guideline only.) First, Japan's data are especially **prone to revision**, and are quite volatile. The 'recession' could easily be revised away. Second, even with the second-half sag, GDP was still up 1.1% y/y in Q4. In a nation where **population** is down 0.5% y/y, that's not a bad performance at all. Third, Japan's **jobless rate** has actually dropped a tick over the past year to just 2.4%, not quite what one would expect in a true recession. And, finally, if Japan was in a recession, someone forgot to tell the **Nikkei**, which is busily approaching a record high (finally poised to eclipse the end-1989 apex) and up an astonishing 15% this year alone. We should all wish for such a dire economic backdrop.

Mixed Messages from the United States

Scott Anderson
Chief U.S. Economist
scotta.anderson@bmo.com

We were hoping for a clearer message from this week's major U.S. economic indicators, one that would swing the economic outlook even further toward the soft-landing camp. Instead, we received, at best, a **muddled message**: stronger January CPI and PPI inflation—both core and headline—than anyone had bargained for; combined with sharp declines in retail sales and manufacturing production, well short of expectations for a modest slowdown in growth. But before we go too far down that rabbit hole, **it is important to not draw too sharp a conclusion from one month of data**.

There were a few one-off factors that may help ease the pain from the January data. Inclement weather (freezing temperatures followed by heavy rainfall) along with falling gasoline prices likely added to the weakness in total retail and motor vehicle sales. Spending is likely to rebound in February and March as (mostly) Spring-like weather erupts and the underlying fundamentals that support real consumer spending growth return. Consumer confidence remains buoyant; U.S. equity markets, already at record levels, continue to rise; and the decline in initial jobless claims over the past two weeks shows labour demand remains solid. As long as people have jobs, and real incomes continue to climb, **we are not too concerned about a one-month stumble in spending**. Even so, the worse-than-expected retail sales data also came with downward revisions for gains in November and December, suggesting less momentum coming into this year. As a result, we have lowered our real consumer spending growth forecast for Q1 to a still-healthy 2.4% a.r. from 3.2% previously.

We also made a downward revision to our business investment growth forecast for Q1, in part due to the worse-than-expected drop in January manufacturing production (down 0.5%). Still, our call for real GDP growth remains at 2.0% a.r. in Q1 given offsetting upward revisions to residential investment and business inventory growth (due to solid readings in the NAHB Housing Market Index and in business inventories). In short, **despite the tweaks in the near-term forecast, the soft-landing narrative remains intact**. Unfortunately, the mixed messages coming from the January data will keep economic and inflation uncertainty high and the Fed on hold as it awaits more data to gain *"greater confidence"* that inflation is moving sustainably toward 2%.

On the inflation front, **the 'hot' January data might not be quite as bad as it seems at first blush**. Over the past three years, CPI inflation has consistently started the year very high even after adjusting for seasonal factors, suggesting there may be residual seasonality that is not yet being fully accounted for. For example, more companies may now decide to raise selling prices altogether at the start of the year before expected year-ahead cost increases. Better to push through somewhat bigger price increases all at once rather than more gradual price increases multiple times a year that could draw unwanted attention. If that is indeed the case, we should see smaller price increases in the months ahead, as we have in recent years—especially if demand continues to cool. As we have long said, the path from 3% to 2% inflation would not be a straight line and could be rocky. The unwelcome January data pushed up our CPI inflation forecast for Q1 to 3.2% a.r. with core CPI now at an elevated 4.0%. However, the likely moderation over the rest of the year only leads to a slight increase to 2.9% in our CPI inflation forecast for all of 2024.

In reality, the CPI acceleration had a bigger impact on the fixed income markets, which have long been positioned for multiple Fed rate cuts this year, starting as soon as March or May. So, many traders had to significantly re-calibrate their expectations. The Fed funds futures probability of a March rate cut is at less than 10% with the probability of a May cut under 30%. The market has scaled back from pricing in six quarter-point rate cuts in 2024 at the start of the year to just over three quarter-point cuts today. **Our refreshed U.S. economic and inflation outlook is still much more consistent with an initial cut around July at the earliest.**

Mind the (Inflation) Gap: CPI vs. PCE

Sal Guatieri
Senior Economist
sal.guatieri@bmo.com

Will the real U.S. inflation report please stand up. A **chunky 0.4% rise in core CPI prices held the yearly rate at 3.9%**. And, the eye-popping 0.8% spike in core services prices (ex-rents) suggests stickiness in labour-intensive industries still struggling with worker shortages. Meantime, the Cleveland Fed's trimmed-mean and weighted-median CPI measures both rose 0.5% last month, suggesting the leap in core prices wasn't related to a few anomalies that are poised to retrace next month. An unwelcome jump in core producer prices only piled onto the bad news. True, one month doesn't make a trend; and, as Scott explains, some of January's spike could be reversed in coming months. But the fact of the matter is that, even if core goods continue to deflate, the Fed's price stability goal could prove elusive unless service costs cool down much further.

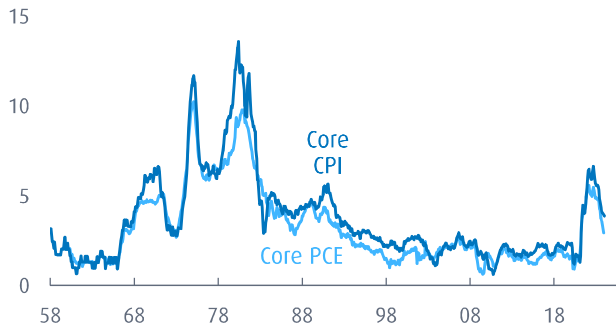
But wait, you say, the Fed doesn't target the CPI but the more comprehensive PCE deflator, which has decelerated rapidly. In fact, core PCE prices rose an annualized 1.9% in the second half of 2023, or a tick *below* the target. On a yearly basis, the **core PCE deflator moderated to 2.9% in December, a full percentage point below the core CPI rate**. Even if prices rise 0.3%-to-0.4% in January, the yearly rate could edge down a tenth or two due to an easy comparison last year. The gap between the two core inflation measures could widen to 1.2 ppts—the largest in over 22 years and three times the long-run median (of 0.42 ppts going back to 1960).

The PCE deflator tends to run slower than the CPI largely because of substitution effects, as shoppers often swap faster-rising items for slower-moving ones. Note in *Chart 1* that the gap tends to widen in high-inflation periods. This gap reflects a mix of different weights on spending categories, different items within categories, and diverse methods of measuring price changes. To help explain the source of the 1.0-ppt spread between the two core measures in December (more than twice the norm), it's best to focus on the two categories—**rent and health care**—that have the biggest weight difference (by far) and often the biggest variation in price movements. Primary rent and owners' equivalent rent account for a combined 43% of the core CPI (as of December 2022), and their 6% rise in the following year added a hefty 2.7 ppts to core CPI inflation in December 2023. By comparison, rent accounts for a smaller (though still large) 17% share of the core PCE deflator, and a mild 1% rise last year added just 0.2 ppts to core PCE inflation. **The net 2.5-ppt contribution of rent to the core rate gap was partially offset by a negative 1.0-ppt contribution from health care.** This reflected the larger weight of health care in the core PCE deflator (22.1% versus 10.1%), combined with a faster increase (about 6%) in medical costs compared with a much milder 0.5% rise in the CPI. Together, **rent and health care accounted for a net 1.5**

ppts of the gap in the two core rates; i.e., more than all of it. Without these two heavyweights, core PCE inflation likely would be above the core CPI rate in December. Then again, excluding shelter, core CPI inflation would also be much lower than it currently is; in fact, just 2.2% in December *and January*, according to the BLS.

Chart 1
Two Cores Are Better than One

United States (y/y % chng)
Core Inflation



Sources: BMO Economics, Haver Analytics, BLS, BEA

Bottom Line: As rent growth moderates this year, inflation should ease further. But sticky services costs, even beyond shelter, suggest the decline—regardless of the survey—will be gradual. This means the Fed might not attain "*greater confidence that inflation is moving sustainably toward 2 percent*" until the summer, thereby delaying rate cuts until the 2024 Olympics are underway.

Dawn of the Budget Season

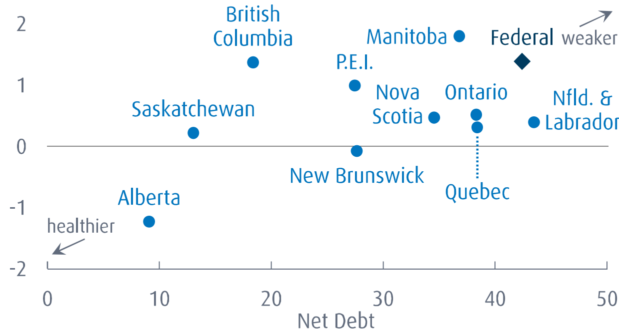
Robert Kavcic
Senior Economist
robert.kavcic@bmo.com

Fiscal nerds, restrain yourselves. The **2024 Canadian budget season is set to get underway** with **British Columbia** first out of the gate on February 22nd, teeing off what should be a fairly muted set of fiscal plans. Current economic conditions, the political backdrop and overall state of Canadian government finances suggest that we're in for a largely steady-as-she goes budget season which, by the way, is hardly a bad thing.

Government finances come into the season in **pretty good shape**, with the fall fiscal update season having yielded few major surprises. The combined provincial budget deficit is currently estimated at a modest $9.7 billion for FY23/24, or 0.3% of GDP. While that marks a deterioration from two consecutive surpluses averaging just under $8 billion in the two prior fiscal years, the books are at or near balance for most. The majority of provinces also carry net debt burdens at 38% of GDP or lower; in some cases, much lower (*Chart 1*). The federal deficit for FY23/24 is currently pegged at $40 billion, or a chunkier 1.4% of GDP, with policymakers still not shy about spending.

Ottawa's latest fiscal monitor shows monthly budget flows falling behind a year ago, which could open some risk to the deficit estimate for FY23/24 and beyond. This would mark **a shift from a few years of perennial upside fiscal surprises** in Canada. At the provincial level, the combined fiscal balance exceeded budget expectations by an average of almost $50 billion per year between FY20/21 and FY22/23, or a hefty 2% of GDP. FY23/24 is tracking very incrementally ahead of expectations. This isn't *bad* news, per se, but the steady stream of *good* news is probably behind us. Part of the reason is that finance departments had been conservative with their **economic assumptions**. While 2023 held up much better than expected, most are now seeing 2024 growth fade below prior plans.

Chart 1
The Lay of the Fiscal Land

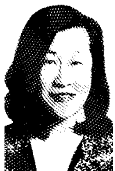


Sources: BMO Economics, provincial budgets/updates

On **the spending side**, higher debt service costs and public-sector wage bills are going to add pressure. Higher bond yields continue to filter through into higher debt service costs, with the provincial total now tracking roughly $5 billion higher than pre-pandemic levels. The better news is that we expect Bank of Canada rate cuts in the second half of the year, and debt service costs are still just 6% of revenues or a full point *below* pre-pandemic levels. Splash spending announcements might be fewer and further between, and even Finance Minister Freeland hinted at *"acting in such a way that creates conditions that will make it possible for interest rates to come down"*—let's assume that means less inflationary fiscal stimulus. This year's **election calendar** is also pretty thin with B.C., New Brunswick and Saskatchewan on deck in the fall.

Finally, the provinces should remain **active borrowers**, with the balance likely stable, capital spending demands still strong and maturities holding relatively steady. The group is on pace to borrow $92 billion this fiscal year, with a few provinces (ON, B.C., SK) already pre-borrowing meaningful amounts for the upcoming fiscal year. On the **credit-rating** front, we'd flag Ontario as ripe for an upgrade if the province lays out a strong budget; while Manitoba and B.C. have been losing some goodwill on that front.

The First Step Is the Hardest



Jennifer Lee
Senior Economist
jennifer.lee@bmo.com

With all of this handwringing about when to move on rates, some central banks were provided more reasons this week to pull the trigger. The majority of the **BoE** is holding off on easing; but, the latest data showed headline and core inflation unexpectedly steady, wage growth slow, and the economy fall into a technical recession. Complicating matters was a rebound in January retail sales, although they're still down over the past three months. That should be enough for at least a few members to say "Fine, let's ease" and call it a day, but services inflation actually heated up to a 3-month high, which bothers not just one of the hawks but Governor Bailey as well. The MPC wants "*more clear evidence*" of cooling inflation and receding wage growth. Meantime, the **ECB** has also been preaching "*patience*" when it comes to rate cuts, particularly from the head of the Bundesbank. He probably gave a side eye to the German government as it slashed its GDP forecast to just 0.2% this year (matching BMO's estimate) from its previous estimate of 1.3%. While we do not expect cuts to come quickly (too soon), **we still look for the BoE to cut in May, and the ECB to do so in June**. But for the **BoJ**, it is a little more complicated. The Bank has been taking baby steps towards getting rid of its negative rate policy. It hasn't even been beating around the bush: Board members have discussed it openly. Unfortunately, the latest GDP report showed the economy contracted in both Q3 and Q4, landing Japan in a technical recession. This would be bad news, even during the best of times. But, with the yen hitting ¥150 again, the Bank risks an even weaker currency if it doesn't move. Getting rid of negative rates may be enough, which we see materializing in **June**. But let's not get too hasty: positive rates can wait.

Priscilla Thiagamoorthy
Senior Economist
priscilla.thiagamoorthy@bmo.com

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

	Good News	Bad News
Canada ▪ Housing market comes into better balance	**Existing Home Sales** +3.7% (Jan.) **Construction Investment** +0.3% (Dec.) **New Motor Vehicle Sales** +16.3% y/y (Dec.) **Core Wholesale Trade Volumes** +0.2% (Dec.) **Global Investors** bought a net $10.4 bln in Canadian securities (Dec.)—mostly in debt instruments	**MLS Home Prices** -1.2% (Jan.) **Housing Starts** -10.2% to 223,589 a.r. (Jan.) **Manufacturing Sales Volumes** -0.1% (Dec.)
United States ▪ Hotter-than-expected inflation likely means the Fed will stay on hold for some time ▪ Some Fed officials are not convinced that inflation is making good progress toward 2% target	**Initial Claims** -8k to 212k (Feb. 10 week) **NAHB Housing Market Index** +4 pts to 48 (Feb.) **Philly Fed Index** +3.3 pts to 45.2; **Empire State Manufacturing** +8.7 pts to 48.4 (Feb.)—both ISM-adjusted **U of M Consumer Sentiment** +0.6 pts to 79.6 (Feb. P)—but no improvement in inflation expectations	**Retail Sales** -0.8% (Jan.)—and **control group** -0.4% **Consumer Prices** pick up to +0.3% (Jan.)—and **core** +0.4%, **supercore** +0.8% **Producer Prices** +0.3% (Jan.)—**services** +0.6% **Import Prices** +0.8% (Jan.) **Industrial Production** -0.1% (Jan.)—and **capacity utilization rate** -0.2 ppts to 78.5% **Housing Starts** -14.8% to 1.331 mln a.r. (Jan.)—weather-related **Building Permits** -1.5% to 1.470 mln a.r. (Jan.) **NFIB Small Business Optimism** -2.0 pts to 89.9 (Jan.) **Budget Deficit** widened to $532 bln (Oct.-to-Jan.) **Global Investors** sold a net $142.0 bln in U.S. securities (Dec.)
Japan ▪ Economy slips into a technical recession… ▪ …BoJ likely to stick with NIRP for some time		**Real GDP** -0.1% q/q (Q4 P) **Machine Tool Orders** -14.1% y/y (Jan. P)
Europe ▪ ECB President Lagarde doesn't want to rush into cutting rates ▪ U.K. in a technical recession ahead of next month's Spring Budget ▪ BoE Governor Bailey sees "*some signs of upturn*" in recent data	**Euro Area—Industrial Production** +2.6% (Dec.) **Germany—ZEW Survey** +4.7 pts to 19.9 (Feb.) **U.K.—Consumer Prices** steady at a two-year low of +4.0% y/y (Jan.)—and **core** +5.1% y/y **U.K.—Producer Prices** -0.6% y/y (Jan.) **U.K.—Retail Sales (incl. Fuel)** +3.4% (Jan.) **U.K.—Employment** +72k; **Jobless Rate** -0.1 ppts to 3.8% (3 mths to Dec.) **U.K.—Payrolls** +48k (Jan.) **U.K.—Average Weekly Regular Earnings** slowed to +6.2% y/y (3 mths to Dec.) **U.K.—Industrial Production** +0.6% (Dec.) **U.K.—Trade Deficit** narrowed to £14.0 bln (Dec.)	**Euro Area—Trade Surplus** narrowed to €13.0 bln (Dec.) **U.K.—Real GDP** -0.3% q/q (Q4) **U.K.—Monthly Real GDP** -0.1% (Dec.)—and **Index of Services** -0.1%
Other ▪ RBNZ Governor Orr and the RBA's Kohler warn that inflation is still too high	**Australia—CBA Household Spending** +3.6% y/y (Jan.) **Australia—Consumer Confidence** +6.2% (Feb.) **Australia—NAB Business Confidence** +2 pts to 1 (Jan.)	**Australia—Employment** +500 (Jan.)—and **Jobless Rate** +0.2 ppts to 4.1%

Feature

Extraordinary Population Delusions and the Trouble with Crowds

Robert Kavcic
Senior Economist
robert.kavcic@bmo.com

Shelly Kaushik
Economist
shelly.kaushik@bmo.com

Canada's population has exploded by 1.3 million people in the past year, or 3.2%, the fastest pace since the 1950s. This surge is rooted in sound principles, but has clearly run amok. Indeed, the narratives around the population boom have, in our view, been off the mark, although recent measures (e.g., caps on international students) suggest that is changing. Here are five pieces of the narrative that are worth challenging:

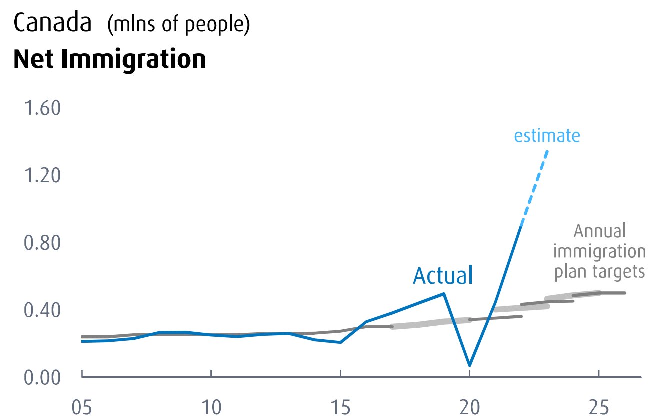
Myth: Immigration targets are carefully managed

Canada has historically boasted a carefully-managed system of permanent resident targets, which remains in place today. In the 2023 Immigration Levels Plan, Canada set permanent resident targets peaking at 500k per year by 2025 and 2026, with roughly 60% of those inflows arriving in the economic class (including high-skilled workers and those covered under provincial nominee programs). Those official immigration targets have been rising steadily from about 300k before the pandemic and around 250k in the decade prior (*Chart 1*).

Now, we'll be among the first to argue that a robust pipeline of skilled immigrants is essential to maintain future labour force and potential output growth. But, the current population 'situation' goes well beyond robust official targets. The roughly 1.3 million net international inflow in the past year has dwarfed these targets, entirely on the back of unchecked nonpermanent resident inflows—split between temporary foreign workers and international students (*Chart 2*).

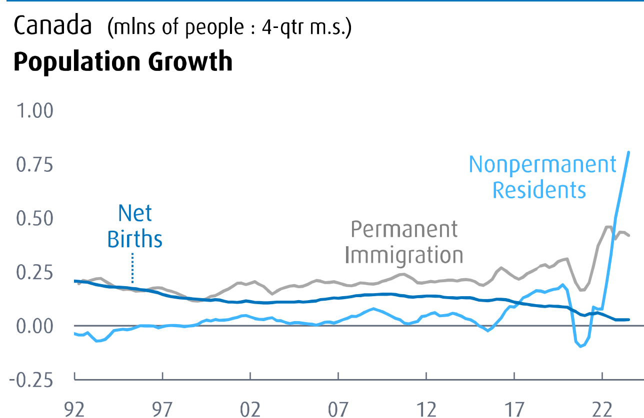
Reality: Canada's well-managed immigration plan has unravelled, and the surge of nonpermanent residents has run beyond anyone's ability to plan. Municipalities can't be expected to prepare for such an inflow, resulting in stress on transportation and service infrastructure. And, it's an acute demand shock that has crushed housing affordability.

Chart 1
Population Tidal Wave



Sources: BMO Economics, Statistics Canada, Government of Canada

Chart 2
Sources of the Population Boom



Sources: BMO Economics, Haver Analytics, Statistics Canada

Myth: Housing affordability is a supply problem and we'll triple construction

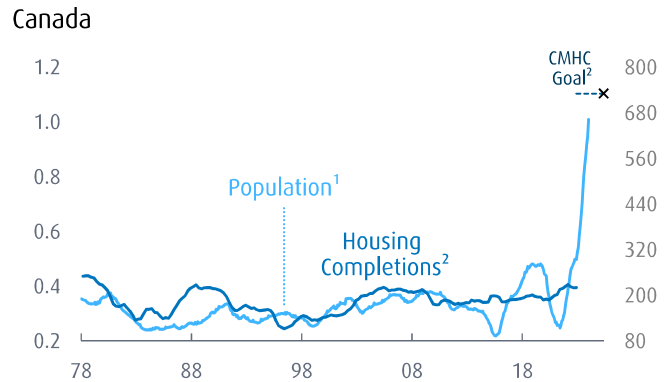
Canada is currently building more than it ever has, with more units now under construction than ever before in raw and in per capita terms. The industry has been operating at full capacity and has shown an all-out ability to complete about 225k-to-250k units per year. Incidentally, at 2.5 people per household, that's just enough to cover official immigration targets and some domestic formation. It's little coincidence that housing affordability was largely in check until about three years ago when

population growth swelled past these targets—see Chart 3 and ask what suddenly changed.

Meantime, federal and provincial measures that hope to triple the rate of housing construction have simply never been realistic—Chart 3 also shows how extreme such targets are. While we applaud measures to speed up the responsiveness of supply (such as faster approval processes, etc.), and welcome tax changes that incent more supply, the reality is that the industry is bound by capacity constraints, and will build based on market conditions. Since the 2022 federal budget that was laden with supply goals, housing starts have actually fallen—as we expected.

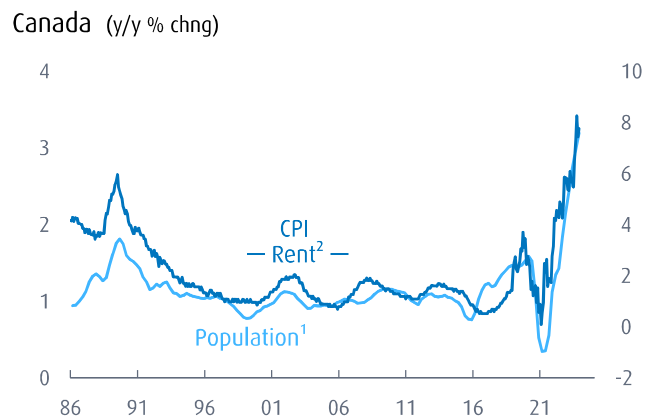
Reality: Canada's housing situation is the result of massive excess demand shocks. Deeply negative real interest rates stoked excessive price gains that are still normalizing; and, a near-tripling in population growth in a short period of time is something no supply curve can adequately respond to.

Chart 3
Pie in the Sky on Supply



[1] (lhs : mlns : y/y chng); [2] (rhs : 000s : 4-qtr m.s.)
Sources: BMO Economics, Haver Analytics, Statistics Canada, CMHC

Chart 4
Inflation Pressure



Sources: BMO Economics, Haver Analytics, Statistics Canada [1] (lhs); [2] (rhs)

Myth: More people is disinflationary

International immigration is a key mechanism with which to ease coming labour shortages and lift potential growth over the longer term. At a time when the Bank of Canada is actively fighting an inflation battle, with an eye on wages, one could think that torrid population flows would help. But, integrating new Canadians into the labour market takes time, and there are often language barriers, skill mismatches or issues with credential recognition—we hear these concerns often in the business community.

In the meantime, while the inflation-absorbing effect of higher labour supply takes time to materialize, elevated population flows add to aggregate demand and inflation pressure immediately, while weighing on per capita growth. Inflation pressure is clear in areas such as housing, health care and other services where supply and infrastructure can't keep up (*Chart 4*).

Reality: An immediate surge in population growth when supply is already struggling to keep up is inflationary in the short run. And, the impact on growth is not entirely clear. Consider that without this demand shock, Bank of Canada policy rates could be lower alongside less pressure on housing and services inflation. As it stands now, these pressures will keep policy rates restrictive for longer than they otherwise would be.

Myth: We need the workers

It's true that Canada's fertility rate has been falling steadily for decades, most recently hitting all-time lows in 2022. As a result, the population mix has been skewing older; and, as we're in the middle of a wave of Baby Boomer retirements (aged 59-78 years this year, according to StatCan), the country's dependency ratio is poised to rise

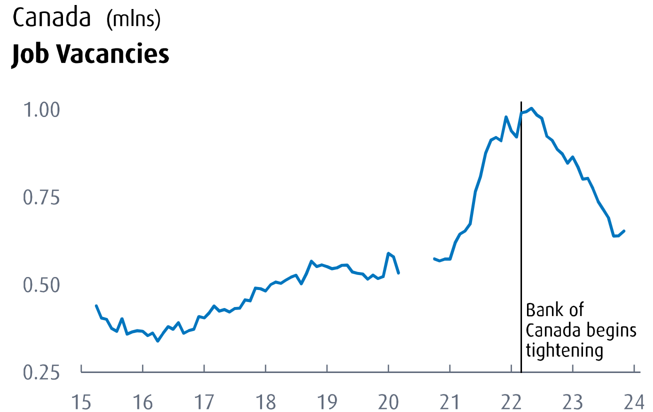
further. All this has led to the need for skilled immigrants to fill the country's labour gaps over the long term.

It's the short term where things get trickier. After experiencing historic tightness during the pandemic, the labour force began loosening in the second half of 2023. As of November, job openings (*Chart 5*) are on a steady path downwards and just above pre-pandemic trends. To be sure, vacancies remain elevated in some sectors (e.g., construction), but even they have fallen and the broader loosening argues against a large-scale labour shortage. Instead, existing avenues (such as the Temporary Foreign Workers program) could fill those gaps while being flexible to market conditions.

Reality: In the long term, Canada's demographic challenges will benefit from the immigration of skilled workers into the country. But, the labour market's return to balance means additional inflows could lead to rising unemployment, without skills- or sector-specific targeting. The jobless rate is now up almost a full percentage point from the cycle low, and the employment rate is down almost a full percentage point, suggesting that the job market is no longer absorbing all of the inflows.

Chart 5

Job Openings Backing Off Recent Highs



Sources: BMO Economics, Haver Analytics, Statistics Canada

Table 1

Balanced Market? Depends Where You Are

Canada — January 2024 (% deviation from trend[1])

Real Home Price

	BC	AB	SK	MB	ON	GTA	Exurbs[2]	Cottage[3]	QC	Atlantic
Peak[4]	23.9	1.2	-2.4	15.4	53.5	47.3	75.6	63.3	33.4	24.6
Latest[5]	-5.1	-9.9	-15.1	2.5	8.2	3.8	19.0	11.4	18.3	21.3

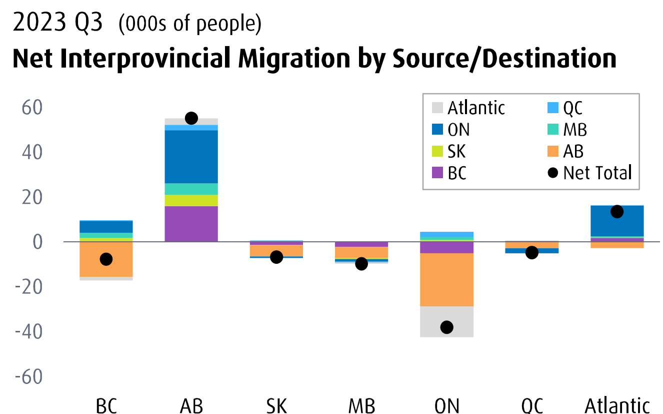
[1] Exponential growth trend since 1980; [2] Barrie, Guelph, Hamilton, Kitchener-Waterloo, London, Niagara, Orillia, St. Catharines, Windsor; [3] Bancroft, Kawarthas, Muskoka-Haliburton, S. Georgian Bay; [4] 2022 peak; [5] using Dec. 2023 CPI *Sources: BMO Economics, CREA, Statistics Canada*

Myth: People want intensification

The pandemic-era trend of larger homes has only partially reversed course, with smaller-sized cities in more affordable regions benefitting from sturdy demand for homes. (The exception being Ontario, where small- to mid-sized cities saw a larger ramp-up in prices during the pandemic; *Table 1*.) Take a look at Chart 6, showing an ongoing outflow from Ontario and BC towards Alberta and the Atlantic provinces. Sure, the absolute flows are flattered by the sheer size of Ontario and BC—but note Quebec, which has a large population and is relatively affordable, is experiencing far smaller outflows. So, there seems to be a clear preference for cheaper, and more spacious, homes. That's little surprise; remember, we're right around the peak of Millennial homebuying age. At the other end, the Baby Boom generation is delaying downsizing longer than ever.

Chart 6

Go West, or East



Sources: BMO Economics, Haver Analytics, Statistics Canada

Reality: While some intensification is a natural by-product of population growth, it is far from clear that this is what people are looking for. In fact, housing demand is telling the opposite story. People are looking for larger homes in more affordable markets. And, let's not pretend that intensification alone will solve our housing crisis, because markets like the GTA have already been intensifying, by rule, for 15 years.

Economic Forecast Summary for February 16, 2024

	2023				2024				Annual		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	2022	2023	2024
CANADA											
Real GDP (q/q % chng : a.r.)	2.5	1.4	-1.1	1.0	0.5	1.0	1.5	2.0	3.8	1.1	0.8
Consumer Price Index (y/y % chng)	5.1	3.5	3.7	3.2	3.3	3.1	2.4	2.5 ↑	6.8	3.9	2.8
Unemployment Rate (percent)	5.1	5.3	5.5	5.8	5.8	6.2	6.5	6.5	5.3	5.4	6.3
Housing Starts (000s : a.r.)	221	246	256	244	230 ↓	230 ↓	235	245 ↑	263	242	235 ↓
Current Account Balance ($blns : a.r.)	-27.1	-29.3	-12.9	1.6 ↓	-6.1 ↓	-11.6 ↓	-14.2 ↓	-14.8 ↓	-10.3	-16.9 ↓	-11.6 ↓
Interest Rates					(average for the quarter : %)						
Overnight Rate	4.50	4.58	5.00	5.00	5.00	4.92	4.50	4.17	2.04	4.77	4.65
3-month Treasury Bill	4.39	4.54	5.02	5.01	4.95	4.85	4.50	4.15	2.17	4.74	4.60
10-year Bond	3.04	3.10	3.64	3.67	3.35	3.25	3.10	3.00	2.77	3.36	3.15
Canada-U.S. Interest Rate Spreads					(average for the quarter : bps)						
90-day	-39	-72	-52	-51	-50	-58	-74	-54	9	-53	-59
10-year	-61	-50	-51	-77	-67	-69	-72	-75	-18	-60	-71
UNITED STATES											
Real GDP (q/q % chng : a.r.)	2.2	2.1	4.9	3.3	2.0	0.8	1.3	1.5	1.9	2.5	2.2
Consumer Price Index (y/y % chng)	5.7	4.0	3.6	3.2	3.1 ↑	3.0 ↑	2.8 ↑	2.7 ↑	8.0	4.1	2.9 ↑
Unemployment Rate (percent)	3.5	3.6	3.7	3.8	3.7	3.9	4.1	4.2	3.6	3.6	4.0
Housing Starts (mlns : a.r.)	1.39	1.45	1.37	1.48	1.40 ↑	1.40 ↑	1.40 ↑	1.41 ↑	1.55	1.42	1.40 ↑
Current Account Balance ($trlns : a.r.)	-0.86	-0.87	-0.80	-0.79 ↑	-0.80 ↑	-0.81 ↑	-0.82 ↑	-0.83 ↑	-0.97	-0.83	-0.81 ↑
Interest Rates					(average for the quarter : %)						
Fed Funds Target Rate	4.63	5.04	5.38	5.38	5.38	5.38	5.04	4.63	1.90	5.10	5.10
3-month Treasury Bill	4.78	5.27	5.54	5.52	5.45	5.45	5.20	4.70	2.08	5.28	5.20
10-year Note	3.65	3.59	4.15	4.44	4.00	3.90	3.80	3.75	2.95	3.96	3.90
EXCHANGE RATES					(average for the quarter)						
US¢/C$	74.0	74.5	74.6	73.5	74.3	74.6	75.1	75.6	76.9	74.1	74.9
C$/US$	1.35	1.34	1.34	1.36	1.35	1.34	1.33	1.32	1.30	1.35	1.34
¥/US$	132	137	145	148	148 ↑	147 ↑	144 ↑	141	131	140	145 ↑
US$/Euro	1.07	1.09	1.09	1.08	1.08	1.09	1.10	1.12	1.05	1.08	1.10
US$/£	1.22	1.25	1.27	1.24	1.26	1.26	1.27	1.28	1.24	1.24	1.27

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
benjamin.reitzes@bmo.com

Shelly Kaushik
Economist
shelly.kaushik@bmo.com

Consumer Price Index

Tuesday, 8:30 am

Jan. (e)	**+0.6% (+0.3% s.a.)**	**+3.4% y/y**
Consensus	*+0.4%*	*+3.3% y/y*
Dec.	-0.3%	+3.4% y/y

CPI Core (% y/y)

	Trim	Median	ex. F&E
Jan. (e)	**+3.8**	**+3.7**	**+3.8**
Dec.	+3.7	+3.6	+3.4

Stickiness? Thy name is **inflation**. Despite the turning of the calendar to 2024, inflation worries remain front and centre. Our call for a 0.6% m/m increase in headline CPI will not help matters. Historically, most price increases in Canada are concentrated in the first half of the year, so prepare for some chunkier gains in the coming months. January prices are also subject to a calendar effect, as some firms use the change in year to adjust prices higher. A number of categories are expected to see strong gains in the month—food, shelter, recreation, alcohol/tobacco. Despite an anticipated large monthly increase, food price inflation is still expected to slow below 5% y/y for the first time since late 2021, with a favourable base effect providing a helping hand. Shelter isn't going to let up much, if at all, with demand continuing to power rents, though somewhat lower mortgage rates point to a smaller (but still large) increase in mortgage interest costs. All told, our call will keep inflation steady at 3.4% y/y (though just barely).

The Bank of Canada's **core inflation** metrics are expected to be flat to up one tick in January, pushing the Trim and Median further above 3.5%, continuing the recent rising trend. That's not what the BoC wants to see and will reinforce its bias to keep policy rates steady at 5% for longer. We anticipate some improvement in the core metrics as the year progresses, but it's going to be a grind. The other core metrics also look to deteriorate with CPIX up three ticks to 2.9% y/y and CPI ex. food & energy up four ticks to 3.8% y/y. We'll also be watching inflation breadth for signs of improvement. Overall, this report isn't expected to be particularly friendly for the BoC. Further notable improvement is needed before rate cuts become a realistic possibility. — B.R.

Retail Sales

Thursday, 8:30 am

		Ex. Autos
Dec. (e)	**+0.5%**	**+0.7%**
Consensus	*+0.8%*	*+0.6%*
Nov.	-0.2%	-0.5%

With the Canadian economy unexpectedly showing signs of life to end 2023, **retail sales** look to bounce back in December from the previous month's decline. We anticipate a 0.5% gain, slightly weaker than the 0.8% preliminary estimate published by StatCan. Higher gasoline prices will provide support, though a smaller increase in autos means retail sales ex-autos were likely stronger than the headline. Importantly, an increase in goods prices suggests sales volumes were softer; we'll be watching that figure, as well as the flash estimate for January, to determine the extent of consumer momentum heading into the new year. — S.K.

British Columbia Budget

Thursday

See Robert Kavcic's Thought on page 6.

United States

Scott Anderson
Chief U.S. Economist
scotta.anderson@bmo.com

Priscilla Thiagamoorthy
Senior Economist
priscilla.thiagamoorthy@bmo.com

FOMC Minutes from January 30-31 meeting

Wednesday, 2:00 pm

Given the unwelcome rise in U.S. CPI inflation and weaker-than-expected retail sales in January, the **Minutes from the January meeting** will get even more scrutiny than usual. Investors are trying to divine from the Minutes' tea leaves not only the likely *timing* of the first Fed rate cut this year, but also the likely *pace* of what is expected to be ongoing easing. Jerome Powell, at his post-January FOMC press conference, counselled a patient data-dependent approach to rate cuts that appears to be playing out with the latest resilient inflation data. The policy statement pledged not to reduce the target range of the fed funds rate until the Committee "*has gained greater confidence that inflation is moving sustainably toward 2 percent*". Most officials have echoed those sentiments in the weeks since. Markets have already priced in later and fewer rate cuts this year, going from six quarter-point cuts (at the beginning of January) to between 3 and 4 cuts now.

We will be hunting for clues on what specific criteria will need to be met for the FOMC to gain confidence to lower rates in the months ahead. We should also get a better sense of the diversity of opinion among participants around the consensus view, including the risks to their forecasts from the December meeting. As well, we will be looking for insights on preliminary plans for the wind-down of the quantitative tightening (QT) program, expected later this year. — S.A.

Existing Home Sales

Thursday, 10:00 am

Jan. (e)	**3.88 mln a.r. (+2.6%)**
Consensus	*3.97 mln a.r. (+5.0%)*
Dec.	3.78 mln a.r. (-1.0%)

Following their worst year in well over two decades, **existing home sales** look to rebound 2.6% in January to 3.88 mln annualized as contract closings jumped in the prior month. Despite overall economic activity holding up quite well in the face of aggressive Fed tightening, the housing market—one of the most interest-rate sensitive parts of the economy—has taken a beating. While mortgage rates are well below the 8%-peak, many existing homeowners remain reluctant to put their properties up for sale, until borrowing costs come down further. That's keeping listings on the lean side. As such, we expect activity in the resale market to remain muted in the first half of the year. — P.T.

Financial Markets Update for February 16, 2024

		Feb 16 [1]	Feb 9	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	4.96	4.95	1	1	-8
	United States	5.36	5.37	-1	3	3
	Japan	-0.11	-0.12	1	7	10
	United Kingdom	5.21	5.32	-11	-11	-11
	Australia	4.34	4.35	0	0	-2
2-Year Bonds	Canada	4.31	4.21	10	22	42
	United States	4.66	4.48	18	27	41
10-Year Bonds	Canada	3.59	3.54	5	10	49
	United States	4.30	4.18	13	18	42
	Japan	0.73	0.72	1	7	12
	Germany	2.40	2.38	2	6	38
	United Kingdom	4.11	4.08	3	18	58
	Australia	4.19	4.13	7	-10	24
Risk Indicators	VIX	14.0	12.9	1.0 pts	0.6 pts	1.5 pts
	Inv. Grade CDS Spread [2]	53	54	-1	-2	-3
	High Yield CDS Spread [2]	345	349	-4	-12	-11
					(percent change)	
Currencies	US¢/C$	74.23	74.29	-0.1	-0.3	-1.7
	C$/US$	1.347	1.346	—	—	—
	¥/US$	150.29	149.29	0.7	1.5	6.6
	US$/€	1.0773	1.0784	-0.1	-1.1	-2.4
	US$/£	1.259	1.263	-0.3	-0.9	-1.1
	US¢/A$	65.31	65.24	0.1	-1.0	-4.1
Commodities	CRB Futures Index	271.28	274.34	-1.1	2.2	2.8
	Oil (generic contract)	78.25	76.84	1.8	6.6	9.2
	Natural Gas (generic contract)	1.61	1.85	-12.9	-36.1	-36.0
	Gold (spot price)	2,010.36	2,024.26	-0.7	-0.9	-2.6
Equities	S&P/TSX Composite	21,302	21,010	1.4	1.9	1.6
	S&P 500	5,023	5,027	-0.1	3.8	5.3
	Nasdaq	15,887	15,991	-0.6	3.8	5.8
	Dow Jones Industrial	38,730	38,672	0.2	2.3	2.8
	Nikkei	38,487	36,897	4.3	7.0	15.0
	Frankfurt DAX	17,104	16,927	1.0	3.3	2.1
	London FT100	7,713	7,573	1.9	3.4	-0.3
	France CAC40	7,772	7,648	1.6	5.4	3.0
	S&P ASX 200	7,658	7,645	0.2	3.2	0.9

[1] = as of 11:20 am *[2] = One day delay*

Global Calendar — February 19–February 23

	Monday February 19	Tuesday February 20	Wednesday February 21	Thursday February 22	Friday February 23
China	**Current Account Balance** [D] **Q4 P** Q3 +$62.8 bln				
Japan	**Core Machine Orders** **Dec. (e) +2.7% -1.3% y/y** Nov. -4.9% -5.0% y/y		**Trade Deficit** **Jan. '24 (e) ¥1.9 trln** Jan. '23 ¥3.5 trln **Machine Tool Orders** **Jan. F (e) -14.1% y/y** Dec. -9.6% y/y	**Manufacturing PMI Services** **Feb. P** Jan. 48.0 53.1 **Composite PMI** **Feb. P** Jan. 51.5	
Europe			**EURO AREA** **Consumer Confidence** **Feb. P (e) -15.8** Jan. -16.1 **FRANCE** **Retail Sales** **Jan.** Dec. -2.4% y/y	**EURO AREA** **Manufacturing PMI Services** **Feb. P (e) 47.0 48.8** Jan. 46.6 48.4 **Composite PMI** **Feb. P (e) 48.5** Jan. 47.9 **Consumer Price Index** **Jan. F (e) -0.4% +2.8% y/y** Dec. +0.2% +2.9% y/y **Core CPI** **Jan. F (e) +3.3% y/y** Dec. +3.4% y/y **ECB Minutes from Jan. 25 meeting** **ITALY** **Consumer Price Index** **Jan. F (e) -1.1% +0.9% y/y** Dec. +0.2% +0.5% y/y **UNITED KINGDOM** **Manufacturing PMI Services** **Feb. P (e) 47.5 54.3** Jan. 47.0 54.3 **Composite PMI** **Feb. P (e) 52.9** Jan. 52.9	**EURO AREA** **ECB 3 Year CPI Expectations** **Jan.** Dec. +2.5% y/y **GERMANY** **Real GDP** **Q4 F (e) -0.3% -0.2% y/y** Q4 P -0.3% -0.2% y/y Q3 unch -0.3% y/y **ifo Business Climate** **Feb. (e) 85.5** Jan. 85.2 **UNITED KINGDOM** **GfK Consumer Confidence** **Feb. (e) -18** Jan. -19
Other		**AUSTRALIA** **RBA Minutes from Feb. 6 meeting**	**AUSTRALIA** **Wage Price Index** **Q4** Q3 +1.3% +4.0% y/y		

[D] = date approximate

Upcoming Policy Meetings | Bank of England: Mar. 21, May 9, June 20 | European Central Bank: Mar. 7, Apr. 11, June 6

North American Calendar — February 19–February 23

Canada

Monday February 19

Family Day (markets closed)

8:30 am	**Industrial Product Price Index**	**Raw Materials Price Index**
Jan. (e)	**+0.5%**	**+1.0%**
Dec.	-1.5%	-4.9%

8:30 am	**Household Credit**	**Mortgage Credit**
Dec.		
Nov.	+3.1% y/y	+3.3% y/y

Tuesday February 20

8:30 am	**Consumer Price Index**	
Jan. (e)	**+0.6% (+0.3% s.a.)**	**+3.4% y/y**
Consensus	*+0.4%*	*+3.3% y/y*
Dec.	-0.3%	+3.4% y/y

8:30 am	**CPI Core (% y/y)**		
	Trim	**Median**	**ex. F&E**
Jan. (e)	**+3.8**	**+3.7**	**+3.8**
Dec.	+3.7	+3.6	+3.4

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

Wednesday February 21

8:30 am	**New Housing Price Index**	
Jan. (e)	**-0.1%**	**-0.7% y/y**
Dec.	unch	-0.9% y/y

Noon — 10-year bond auction $5.0 bln

Thursday February 22

8:30 am	**Retail Sales**	**Ex. Autos**
Dec. (e)	**+0.5%**	**+0.7%**
Consensus	*+0.8%*	*+0.6%*
Nov.	-0.2%	-0.5%

2-year bond auction announcement

British Columbia Budget

Friday February 23

Ottawa's Budget Balance[D]	
Dec. '23	
Dec. '22	-$2.0 bln

United States

Monday February 19

Presidents' Day (markets closed)

Tuesday February 20

10:00 am	**Leading Indicator**
Jan. (e)	**-0.3%**
Consensus	*-0.3%*
Dec.	-0.1%

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

11:30 am — 13- & 26-week bill auctions $149 bln

1:00 pm — 52-week bill auction $46 bln

1:00 pm — 42-day cash management bill auction $80 bln

Wednesday February 21

7:00 am	**MBA 30-year FRM**
Feb. 16	
Feb. 9	6.87%

2:00 pm — FOMC Minutes from January 30-31 meeting

Fed Speakers: Atlanta's Bostic (8:00 am); Governor Bowman (1:00 pm)

11:30 am — 2[R]-year FRN auction $28 bln

11:30 am — 17-week bill auction

1:00 pm — 20-year bond auction $16 bln

Thursday February 22

8:30 am	**Initial Claims**
Feb. 17 (e)	**218k (+6k)**
Feb. 10	212k (-8k)

8:30 am	**Continuing Claims**
Feb. 10	
Feb. 3	1,895k (+30k)

8:30 am	**Chicago Fed National Activity Index**
Jan.	
Dec.	-0.15

9:45 am	**S&P Global PMIs**	
	Mfg.	**Services**
Feb. P (e)	**50.1**	**52.0**
Jan.	50.7	52.5

10:00 am	**Existing Home Sales**
Jan. (e)	**3.88 mln a.r. (+2.6%)**
Consensus	*3.97 mln a.r. (+5.0%)*
Dec.	3.78 mln a.r. (-1.0%)

10:00 am — Quarterly Services Survey (Q4 A)

Fed Speakers: Vice Chair Jefferson (10:00 am); Philadelphia Harker (3:15 pm); Governor Cook (5:00 pm); Minneapolis' Kashkari (5:00 pm); Governor Waller (7:35 pm)

11:00 am — 2-, 5- & 7-year note auction announcements

11:00 am — 13- & 26-week bill auction announcements

11:30 am — 4- & 8-week bill auctions

1:00 pm — 30-year TIPS auction $9 bln

Friday February 23

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

Upcoming Policy Meetings | Bank of Canada: Mar. 6, Apr. 10, June 5 | FOMC: Mar. 19-20, Apr. 30-May 1, June 11-12

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