BMO Economics | A weekly financial digest

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Focus

BMO Economics
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It's Earlier than You Think

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

Central banks continue to **preach patience** on the prospect of **rate cuts**, albeit while also **dangling tantalizing hints** that it may be **only a matter of time**. The February jobs data mostly delivered the same message, with both the **U.S.** and **Canada** reporting **above-consensus employment gains**—hence, the need for patience—but also an uptick in unemployment and calmer wage growth—hence, the prospect of rate cuts. Rare is the day that the dual North American job reports are in sync, but this may have been one of those days. Both were **flashy on the surface**, suggesting zero stress in the economy, but both had rather obvious **details** that were **far from stellar**.

February U.S. payrolls topped expectations, yet again, with a sturdy 275,000 advance, although the two prior months were revised down heavily to much more moderate advances (averaging 260,000). However, the companion household survey reported a third consecutive job decline, lifting the unemployment rate two ticks to 3.9%. That is the highest rate in over two years, and half a point above last year's low—approaching Sahm Rule terrain. And, after lurching higher to start the year, average hourly earnings rose just 0.1%, trimming the annual pace to an acceptable 4.3% clip. That's still more than one point above pre-pandemic norms, but not especially troublesome in light of stronger productivity growth.

Prior to the payroll report, markets were enthused when Fed Chair Powell mused that: "*When we get that confidence* (on sustainably returning to 2% inflation)*, and we're not far from it, it will be appropriate to begin to dial back the level of restriction so that we don't drive the economy into recession."* This appeared to be a somewhat dovish turn from his by-the-book midweek testimony to the House, which had made few waves.

On net, bond yields took another step back on the week, with 10-year Treasuries dipping below 4.1% for the first time in a month. With a mid-year rate cut coming into better focus, equities continue to do their thing, with AI-related stocks lifting the major averages to yet new record highs. Notably, other markets are also rallying hard as the steam comes out of rates—both bitcoin and gold hit highs this week.

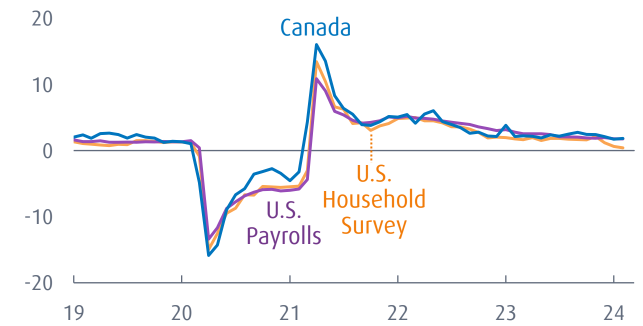
To keep the broad rally going, the inflation news must head in the right direction. **Next Tuesday's CPI now looms large**, with the headline expected to post another meaty rise of 0.4%, holding the annual rate steady at 3.1%. The news on core is expected to be slightly better than last month, with a 0.3% m/m read clipping the yearly rate two ticks to 3.7%. That result will not settle any debate, but at least it won't rule out a June move. Our view is that **there are likely to be some bumps along the road to lower inflation**, especially with growth still chugging along and financial conditions loosening. In turn, this points to a lack of urgency to cut rates, and **we continue to expect the first move to arrive in July**.

One caveat is that there are the **particulars of the political calendar** which could weigh in, as much as the Fed attempts to stay above the fray. And the reality is that politics will intrude into the commentary after any decision this year, now that we have the two main combatants in place. **The Fed may not be interested in politics, but politics are very much interested in the Fed.**

Politics are even intruding into the **Bank of Canada's radar**, as the **Prime Minister** recently suggested after the latest CPI that: *"We're optimistic that the Bank of Canada* *will start bringing down interest rates sometime this year—hopefully sooner rather than later."* While many economists immediately clutched their pearls, the PM did generously add *"But that's their decision to make"*.

Increasing the pressure, **Finance Minister Freeland** has specifically pledged that this year's fiscal plan will be crafted to set conditions for rates to come down, implying little or no net new stimulus is forthcoming in the **April 16 budget**. A small issue on that front is that the provinces are not playing ball—it's early days still, but the theme from this year's round of provincial budgets is more spending, larger deficits.

Chart 1
Some Synchronicity



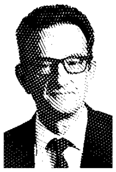
Sources: BMO Economics, Haver Analytics, Statistics Canada, BLS

For the Bank of Canada's part, **this week's rate decision** offered no surprises and the language in the statement and at the press conference was decidedly neutral. Markets were slightly disappointed that the Bank didn't make a clearer step to rate cuts, and Macklem flatly suggested it was just too early. Canada's **solid job gain** of 40,700 last month reinforces the point that growth is hanging in there, and rate cuts are not urgently required. However, as always, we will add the big fat asterisk of **surging population growth**, which is exaggerating the strength of a wide variety of indicators—especially headline job gains. Canadian job growth has been right in line with U.S. payrolls over the past year at 1.8% y/y, but miles above the U.S. household pace of just 0.4% y/y (*Chart 1*). Still, a rise in the unemployment rate to 5.8% and some modest cooling in wages suggest that the job market is indeed loosening—gradually—setting the stage for eventual rate cuts.

The crucial housing market is eagerly awaiting rate relief in Canada. The early results for February home sales suggest they stepped back after a brief bounce around the turn of the year. Of course, the irony is that **if housing rebounds too vigorously to lower rates, it will by itself limit the scope for lower rates**. While the important five-year bond yield has risen about 25 bps from end-2023 lows, and appears to have stabilized just below 3.5%, it's still down almost 100 bps from last fall's high—a key reason home sales perked up to start this year.

Our call has consistently been that the Bank will start trimming rates in June, and cut by a cumulative 100 bps this year. The combination of Macklem's studied caution and still-firm job gains suggests the risk to this call is a) later and b) slower rate cuts. Note also that the Bank specifically pointed to robust equity markets in its statement this week, and looser financial conditions in their comments. While the TSX may be lagging, the reality is that Canadians are also active investors in hot U.S. tech stocks, if not crypto and precious metals. Overall, even with daylight savings time arriving this Sunday, the risk is that **it's still earlier than you think for rate relief**, it seems.

Mixed Labour Market Data Not Helping Early Rate-Cut Cause



Michael Gregory, CFA
Deputy Chief Economist
michael.gregory@bmo.com

The U.S. economy is slowing but continues to grow comfortably above its potential pace. This is preventing excess labour demand and consequent wage pressures from ebbing more meaningfully. The Fed argues policy is restrictive enough to remedy these things; it's only a matter of time. In this week's congressional confab, **Fed Chair Powell** said (our emphasis): *"We are waiting to become more confident that inflation is moving sustainably down to 2%. When we do get that confidence, and we're not far from it, it will be appropriate to begin to dial back the level of restriction so that we don't drive the economy into recession."* Unfortunately, **this week's labour market data were a mixed bag** when it comes to confidence building.

Payroll **employment** expanded a stronger-than-expected 275k in February (by 75k, according to consensus) but there were 167k worth of downward revisions. However, the underlying trend remains one of resiliency. The average growth in payrolls over the past three months was 265k, up from 231k over six months. Meanwhile, household employment recorded its third consecutive decline (184k). This caused growth to slow to 0.4% y/y, compared to 1.8% for payrolls, serving another plate of abnormal relative performance for the Fed to fret over (the other is the abnormally wide inflation gap between the core CPI and core PCE price index).

The **labour force** increased 150k in February after a couple of declines. This caused the unemployment rate to rise from 3.7% to 3.9% (the latter barely rounding up from 3.857%). The jobless rate has spent the past seven months in the 3.7%-to-3.9% range, up from rates as low as 3.4% just 10 months ago. But these are all still below the FOMC's median projection of 4.1% for the longer-run level.

Average hourly **earnings** inched up 0.1%, last seen as low exactly two years ago. This caused wage growth to slow to 4.3% y/y from 4.4%, back again at the bottom of the 4.3%-to-4.5% range in place for the past seven months. Hope for a bottom breach is being boosted by slightly slower growing three- and six-month trends. But it's also being dashed by the degree of excess labour demand.

Job **openings** dipped 26k in January as payrolls expanded 229k, following a similar juxtaposition in December (openings -42k, payrolls +290). In turn, labour demand (payrolls + openings) lifted meaningfully in the past two months, hitting a second consecutive record high. And with supply (labour force) slipping in these two months (as noted above), this worsened the market imbalance. We don't know what happened to job openings in February, but payrolls outpaced the labour force.

Despite the increase in excess labour demand, employees weren't feeling more emboldened to switch jobs in search of higher pay. The **quits** rate dipped a tenth to 2.1% in January, barely above the long-run median (2.0%). At the height of the 'Great Resignation' it was 3.0%. However, according to ADP, in February, workers who switched jobs saw their annual pay jump 7.6%. This was up from 7.2% in January, marking the first month-to-month move up since November 2022.

Bottom Line: The labour market has lots of moving parts. We reckon they should sort themselves out directionally amid ebbing momentum during the next four months, in time for our still-expected inaugural Fed rate cut on July 31.

The Household Wealth Rollercoaster

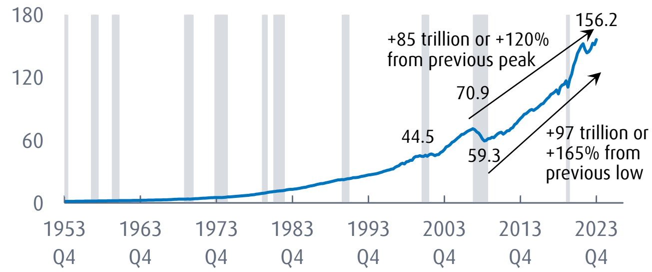
Scott Anderson
Chief U.S. Economist
scotta.anderson@bmo.com

Analysts have placed much of their attention on the **health of the U.S. consumer** by focussing on the excess personal savings accumulated during the pandemic. Recent studies suggest that rising prices over the past two and a half years have eaten away much of those excess savings, returning them back to pre-pandemic trends. The implication being that consumer spending growth should slow back to pre-pandemic rates, given the now highly restrictive stance of monetary policy.

Less cited, but also extremely important for the consumer spending outlook, has been the accumulation of excess household net worth over the first two years of the pandemic and the subsequent decline. But, with U.S. stock markets and home prices once again at, or near, record highs, **the wealth effect** has been, and will continue to be, **an important contributor to the strength of real consumer spending**. The Federal Reserve's Flow of Funds data, released this week, showed another big $4.84 trillion increase in nominal household net worth in the fourth quarter of last year.

Chart 1
Household Net Worth an Important Support for Consumer Spending

United States ($ trlns)
Net Worth — Households and Nonprofit Organizations



Shading marks U.S. recessions
Sources: BMO Economics, Haver Analytics, Federal Reserve Board

The San Francisco Fed, in a recent Economic Letter, took an eye-opening look at the rise and fall of real (i.e., inflation adjusted) household net worth since the pandemic began. They found that large government cash transfers and expanded unemployment insurance directly contributed to a rapid accumulation of household assets. By the end of 2021, **real household net worth had ballooned by $23 trillion or 20% over two years**, reaching an all-time high of $135 trillion in 2017 dollars. By 2022, inflation had picked up, the Fed was hiking interest rates aggressively, and equity prices plunged, pushing real financial assets down by around 14%. Equity holdings make up about half of overall household financial assets, so big price swings can have outsized impacts.

The Fed letter concluded that **real household net worth has now largely normalized back down to its pre-pandemic trend**, after peaking as much as $13 trillion above that trend. Notably, real household financial assets alone (checking and savings deposits, corporate and noncorporate equity, and pension entitlements), were running about $7.3 trillion below their pre-pandemic trend in 2023Q3, as household equity holdings decreased by 17% in 2022. Looking at more liquid real checking and savings deposits, the Fed found overall real liquid assets have also returned to their pre-pandemic trend with a big spike in real checking account balances largely being offset by big declines in real savings account deposits.

In short, the unprecedented 20% rise in real household net worth over the first two years of this pandemic was likely an important driver of real consumer spending growth. But here, too, thanks in part to a more restrictive monetary policy and an end to government pandemic assistance, real household net worth growth appears to be returning to pre-pandemic trends. That should continue to sustain real consumer spending growth without turbo-charging it.

Bank of Canada Keeps Its Eyes on the Prize

Benjamin Reitzes
Canadian Rates & Macro Strategist
benjamin.reitzes@bmo.com

The Bank of Canada stuck to the script at the March policy announcement, repeating that there's still more work to be done on the inflation front. The tone from the Bank was balanced, but markets were disappointed by the lack of increased dovishness.

Inflation remains the main focus for policymakers who clearly aren't comfortable with the current deviation from the 2% target. The statement highlighted that "*underlying inflation pressures persist*" and core inflation remains in the 3%-to-3.5% range. In addition, Governor Macklem noted that the share of CPI components rising at 3% is well above the historical average, even if there's been some improvement there. While there's still work to be done on inflation, the trend is the BoC's friend, and the January MPR is projecting inflation to fall below 3% in the second half of the year.

Governor Macklem also pushed back on the idea that policymakers could start looking through elevated shelter inflation. While CPI excluding mortgage interest costs is at 2% y/y, that's clearly not a road the Bank is willing to go down. Macklem highlighted that the preferred core metrics already exclude big movers—many of which are in the shelter basket. We have no argument with the BoC there, as moving the inflation goalpost before reaching the target will only tarnish its credibility.

On the **growth** front, the economy has performed a bit better than expected, but still below potential. In addition, the details of Q4's growth were lacklustre, with domestic demand contracting for the third time in the past five quarters, despite booming population growth. The main takeaway here from a policymaking perspective is that consistent below-potential growth is contributing to disinflationary pressure which will help pull inflation back to 2% over time. How much time remains the question.

The Bank's relatively hawkish tone is consistent with our thesis that policymakers won't want to sound materially more dovish until rate cuts are almost imminent (e.g. not prior to the meeting before a potential ease). That signal could be in April, but is dependent on the coming CPI figures (which don't look favourable on a preliminary basis) and the Business Outlook Survey. Our base case remains for a June start to cuts, but the risks are skewed toward a later start if the inflation figures don't behave.

Key Takeaway: The Bank of Canada is in no rush to cut rates, as it waits for inflation to make further progress before shifting gears.

ECB Gives Clarity and Colour for the Coming Cut


Jennifer Lee
Senior Economist
jennifer.lee@bmo.com


Stephen Gallo
Global FX Strategist
stephen.gallo@bmo.com

Well, three out of the four characteristics fit. No, not diamonds, but the ECB's guidance. We typically don't hear such **clarity** often from the ECB. Yes, we know that it will make decisions based on the data (as it is data-dependent) and not on the calendar. But the fact is that **President Lagarde**, in the first 15 minutes of the press conference, dropped a big hint that **June** is the likely month for the **first rate cut since 2016**. She prefaced it with a bit of **colour**, by saying that more evidence of slower inflation is needed, or more data. "*We'll know a little bit more in April*" (and she provided a visual… using her thumb and index finger to demonstrate "*little*") "*and we'll know a lot more in June*". Well! That was almost like wording given by the Norges Bank, or Brazil's central bank. In fact, she used that reference to June three times during the 55-minute-long press conference, in case anyone missed it the first time.

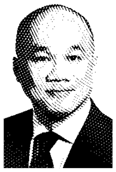
With the exception of that hint—and a strong one at that—the decision and the press conference didn't shed any other new light. It was interesting that rate cuts were not discussed; but, the "*dialling back*" of its restrictive stance was. As our **Stephen Gallo, Global FX Strategist** put it, the comments were still guarded but were dovish, on net. "*Importantly, the ECB does not have the bloc falling significantly below the 2% target for any of the FY projections (yet). This year's headline HICP has been revised lower, but the following years are basically unchanged. From their perspective, easier financial conditions—over the course of the year—and eventual full-scale easing, will be supportive.*"

A parade of Governing Council members emerged afterwards, and it was notable that some of the normally hawkish types supported President Lagarde's views. **Germany's Joachim Nagel** admitted that "*the probability is increasing that we could see an interest rate cut before the summer break*", **Finland's Olli Rehn** said that "*the risks of premature… rate cuts… have substantially decreased…*", and **Lithuania's Gediminas Simkus** said "*June is the possible month for a rate cut.*" Even **Austria's Robert Holzmann** seemed to shift a tiny bit… "*One of the decision yesterday was no change but a change may be in preparation.*" According to Reuters' sources, an "*overwhelming majority*" support a June cut and some are proposing a July one, too, to appease those who favour an earlier rate reduction (April).

So what next? Watch all the data. Before the June 6 announcement, there will be three more CPI reports to dissect (for March, April and May), labour costs, the ECB's survey of CPI inflation expectations, and its negotiated wage tracker. The latter will have the Q1 results (Q4 improved… it would be ideal if Q1 did, too). If activity continues to cool, along with price pressures, look for key rates to be reduced by 25 bps at the June meeting.

Note that the **BoE's** meeting on March 21 will also be under the microscope. We expect the Bank to cut in May, but keep an eye on the **February jobs report** (particularly, the wage measure) and **January GDP**, due March 12 and 13.

Can China's Economy Grow 'Around 5%' This Year?



Art Woo
Senior Economist
art.woo@bmo.com

It's not surprising that this past week's "Government Work Report" set out a 2024 **real GDP growth target for China of '*around 5%*'**, the same as last year. After all, the provinces had let the cat out of the bag in January by announcing GDP growth targets in the same range. There are **two key reasons** why we think the authorities set out a seemingly ambitious objective once again. First, the country's longer-term goal to **become a moderately-developed country** remains intact, as was laid out in "Vision 2035" a few years back. This effectively requires the economy to grow by an annual average of 4.7% until then. Second, we suspect that if the authorities were to lower the annual GDP target, to say a more realistic 4.0%-to-5.0% range, then it could undermine **business and consumer confidence**, which remains fragile.

Nonetheless, we, along with many other China-watchers, believe **Beijing will face a difficult (albeit not impossible) task** in meeting the '*around 5%*' objective. Note we are still forecasting real GDP to grow 4.4% in 2024 and 4.5% in 2025. This is not much different from the latest consensus forecasts of 4.6% and 4.3%, respectively. The good news is that the global trade/tech cycle looks to be turning the corner. This was reflected in the stronger-than-expected 7.1% y/y rise in merchandise exports in the January-February period, though this period's data benefitted from a low base of comparison. The bad news is that it appears that domestic-oriented activities remain in the doldrums. Of prominence, the China Real Estate Information Corp. said that the value of new home sales from the country's 100 largest property developers declined 60% y/y in February (vs. -34% in January). There are reports that consumer spending may have picked up as travel surged during last month's Lunar New Year holidays, but we'll need to wait for the official retail sales data to be released before we can make any conclusions. Meantime, the latest PMI releases suggest that the job market remains in a weakened state.

Thus, the chorus of calls for greater fiscal and monetary stimulus has once again grown louder in recent days. No one is advocating for the big bazooka to be unleashed as was the case during the Great Recession. However, the **fiscal measures accompanying the growth target announcement were quite light** in size and detail. This was highlighted by the official budget deficit target of around 3.0% of GDP, again the same as last year. Although the special government bond issuance was raised to CNY4.0 trillion (from CNY3.9 trillion), it looks like the authorities will be forced to do more in the coming months. Beyond more government spending, it's clear that what the Middle Kingdom's economy needs at this juncture of its development (and yes, you guessed right) are structural reforms that will specifically encourage its citizens to spend more rather than continue accumulating savings. This admittedly requires tough, longer-term solutions to be implemented such as building a stronger social safety net, increasing the labour share of income and improving retirement benefits. And no, none of these changes appear to be on the near-term horizon.

Key Takeaway: As former Premier Wen Jiaobao famously stated way back in 2007, China's economy had some major problems as it was *"unstable, unbalanced, uncoordinated and unsustainable"*. Most of these words still hold true today, which is to suggest that in the absence of a major increase in stimulus and/or efforts at structural reform, the economy may be in for another rocky ride like last year.

Priscilla Thiagamoorthy
Senior Economist
priscilla.thiagamoorthy@bmo.com

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

Canada

- BoC on hold at 5.0%
- Gov. Macklem: inflation progress will likely be *"gradual and uneven"*
- C$ strengthens
- Surging population boosts job gains, though details suggest cooling labour market

Good News

Employment +40,700 (Feb.)
Average Hourly Wages eased to +5.0% y/y (Feb.)
Auto Sales +24.4% y/y (Feb.)
Merchandise Trade Balance swung to a $0.5 bln surplus (Jan.)
Labour Productivity +0.4% (Q4)
Building Permits +13.5% (Jan.)
S&P Global Services PMI +0.7 pts to 46.6 (Feb.)

Bad News

Jobless Rate +0.1 ppts to 5.8% (Feb.)
Capacity Utilization -0.1 ppts to 78.7% (Q4)
Ivey PMI -2.6 pts to 53.9 (Feb.)

United States

- Chair Powell hints rate cuts likely *"not far"*
- Fed Beige Book: Economic activity "*increased slightly, on balance, since early January*"
- Pres. Biden touts a still-sturdy job market in State of the Union address

Good News

Nonfarm Payrolls +275,000 (Feb.)—but prior months revised down
Average Hourly Earnings slowed to +0.1% (Feb.)
Auto Sales climb to 16.0 mln a.r. (Feb.)
Job Openings slip to 8,863k (Jan.)
Consumer Credit +$19.5 bln (Jan.)
Household Net Worth +3.2% to $156.2 trln (Q4)
Initial Claims unch at 217k (Mar. 2 week)

Bad News

Jobless Rate +0.2 ppts to 3.9% (Feb.)
ISM Services PMI -0.8 pts to 52.6 (Feb.)
Factory Orders -3.6% (Jan.)
Global Supply Chain Pressure Index +0.1 (Feb.)—but still near normal
Goods & Services Trade Deficit widened to $67.4 bln (Jan.)

China

- 2024 growth target remains at *"around 5%"*; PBoC hints at more cuts to RRR

Good News

Exports +7.1% y/y; **Imports** +3.5% y/y (Jan.-to-Feb.)
Foreign Reserves $3.2 trln (Feb.)

Bad News

Caixin Services PMI -0.2 pts to 52.5 (Feb.)

Japan

- Pickup in Tokyo inflation and wages puts pressure on BoJ to act… JPY rallies

Good News

Capital Spending +16.4% y/y (Q4)
Real Cash Earnings -0.6% y/y (Jan.)—improving
Bank Lending ex. Trusts +3.4% y/y (Feb.)

Bad News

Household Spending -6.3% y/y (Jan.)
Tokyo Core CPI accelerates to 2.5% y/y (Feb.)

Europe

- ECB on hold but hints strongly at June rate cut
- U.K. Spring Budget causes little market reaction ahead of general election

Good News

Euro Area—Producer Prices -0.9% (Jan.)
Germany—Industrial Production +1.0% (Jan.)
Germany—Trade Surplus widened to €27.5 bln (Jan.)

Bad News

Euro Area—Retail Sales +0.1% (Jan.) —below expected
Germany—Factory Orders -11.3% (Jan.)
Germany—Producer Prices picks up to +0.2% (Jan.)
France—Industrial Production -1.1% (Jan.)
France—Trade Deficit widened to €7.4 bln (Jan.)

Other

- Bitcoin, gold jump to record highs

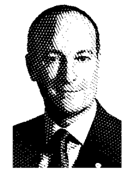
Good News

Australia—Trade Surplus widened to A$11.0 bln (Jan.)

Bad News

Australia—Real GDP +0.2% q/q (Q4)—stalled consumer spending

Canadian Growth: Time for a Rethink

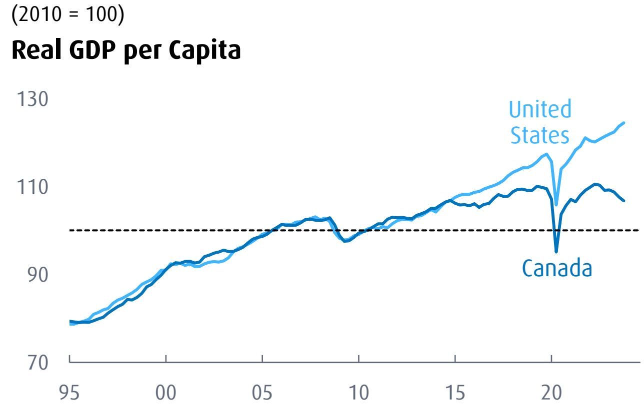


Douglas Porter, CFA
Chief Economist
douglas.porter@bmo.com

It's an open secret that Canadian GDP is heading in reverse on a per capita basis. While the short-term cyclical story has been one of some modest resiliency, partly courtesy of a perky U.S. economy, the broad macro figures have also been flattered by the strongest population growth in decades. Indeed, it would be an unmitigated disaster if the economy was unable to expand at least a little bit when the adult population was growing in excess of 3% y/y. Stacked up against that reality, the 1% GDP growth of the past year is in fact quite meager. This is starkly portrayed in Chart 1, a now infamous gauge of Canada's deep underperformance relative to the U.S. economy, which has only truly emerged in the past decade.

True, **the U.S. may be a tough comparison**, given it has had one of the best recoveries from the pandemic, and it has been juiced by a very aggressive—and perhaps ill-advised—loosening of fiscal policy. But even compared with **Australia**, an economy much more akin to Canada's and which also saw a small sag in per capita GDP last year, the comparison is far from flattering: Australia has grown 6% faster on a per person basis than Canada in just the past four years, and 15% faster since 2000 *(Chart 2)*. The over-riding point is that, even with a small bounce in Q4, **Canadian productivity is in a prolonged slump**, and **GDP per person is no higher now than it was at the end of 2014**, nine long years ago.

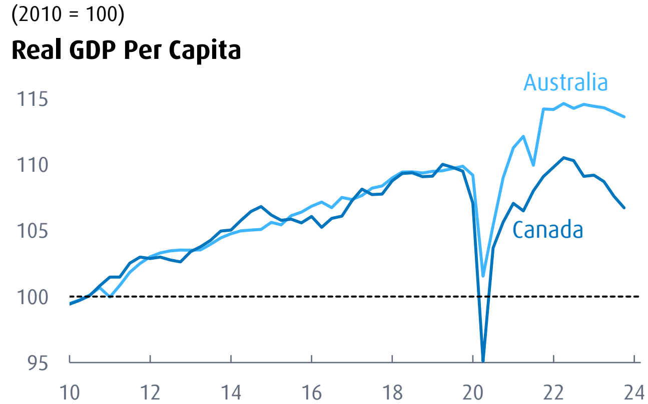
Chart 1
Separate Ways



Sources: BMO Economics, Haver Analytics, Statistics Canada, BEA

This woeful performance is now well known. The question is **what do we do about a problem like measly growth?** It just so happens that former Finance Minister Bill Morneau tasked an **Advisory Council on Economic Growth** to consider this very issue, and the Council delivered its final report on December 1, 2017 [1]. At just over six years ago, it's still fairly fresh, albeit rudely interrupted by a pandemic. So, to avoid reinventing the wheel, it's well worth reviewing its major findings. The report fretted that real GDP growth was only going to average 1.5% over the next 50 years, based on historical productivity trends of 1.1% per year, and GDP per person could ease to "just" 0.8% growth on average over the same period (versus 1.9% in the prior 50 years). It would be churlish to say in hindsight "we wish".

Chart 2
Canada Also Down Under Australia



Sources: BMO Economics, Haver Analytics, Statistics Canada, ABS

Not satisfied with the prospect of sub-1% growth per person, **the Council offered a wide variety of recommendations**, some of which remain eminently reasonable (example: a targeted review of our tax system). As a brief reminder, the major proposals are summarized in Table 1 (end of article), but we'll focus on the headliners: Create an Infrastructure Bank (CIB) to boost such spending, become a top-tier foreign direct investment destination, increase annual permanent immigration and qualify more international students, support skills training, raise workforce participation, and strengthen business investment. Ottawa seized on some of the suggestions nearly immediately—aggressively so on the immigration file—made some partial steps on others, and have let some slip; a mixed response overall.

The **CIB** has been up and running for more than six years, and is still finding its way, with outstanding loans of $11.6 billion at end-2023. The on-the-ground reality is that infrastructure spending overall has firmed slightly in recent years, but it's almost exactly in line with its 20-year average as a share of GDP (*Chart 3*). Overall, nothing has changed significantly on this front, albeit with some very modest improvement.

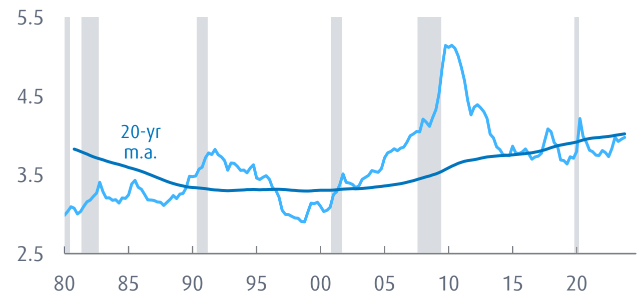
In contrast, the situation in **FDI remains weak**. Inflows to Canada last year were $60 billion, right in line with the average of the past five years, but also little different from levels prevailing prior to 2017. Meantime, Canadian FDI outflows were nearly twice as large last year at $113 billion, leaving a sizable net FDI outflow of $53 billion (*Chart 4*). That's not a record high, but after decades of rough balance, FDI is now consistently in a net outflow position of nearly 2% of GDP. And, notably, even portfolio investment flows dropped into a rare deficit in 2023, driven by record net selling of Canadian equities by non-resident investors. Thus, Canada recorded a rare trifecta in 2023 with deficits in FDI, portfolio flows, and the current account, for only the second time in the past 40 years.

The major policy measure to spur capital spending was arguably the accelerated capital cost allowance in the fall fiscal statement in 2018. Suffice it to say that **Canada is still awaiting a private sector investment boom**. Real outlays on equipment and structures were lower in Q4 of last year than at the end of 2017, and even below levels prevailing as far back as 2008. A steep decline in spending in the oil & gas sector is a big factor, but no other sector has stepped in to fill the void. Spending on machinery & equipment has been flat on balance for nearly 20 years in real terms, and is now just 40% of the level of spending on residential structures in nominal terms (*Chart 5*). From 1965 to 2005, spending on M&E was higher than on housing. Given that all the focus is now on accelerating homebuilding, we're unlikely to ever see M&E above housing outlays again.

The picture on increasing **workforce participation has been mixed**. The overall rate has actually dropped from just over 66% in 2017 to just above 65% now. But much of this can be attributed to the relentless demographic

Chart 3
Building Block

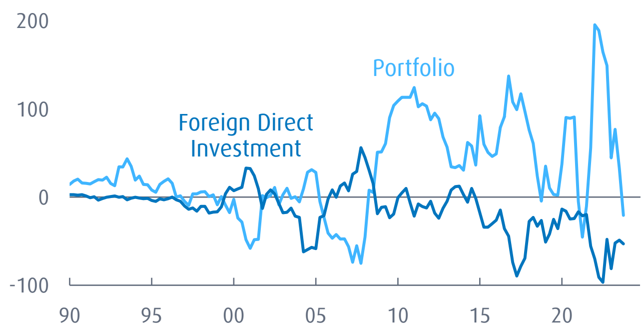
Canada (% of real GDP)
Government Fixed Capital Spending



Shading marks periods of U.S. recession
Sources: BMO Economics, Haver Analytics, Statistics Canada

Chart 4
Capital Outflows

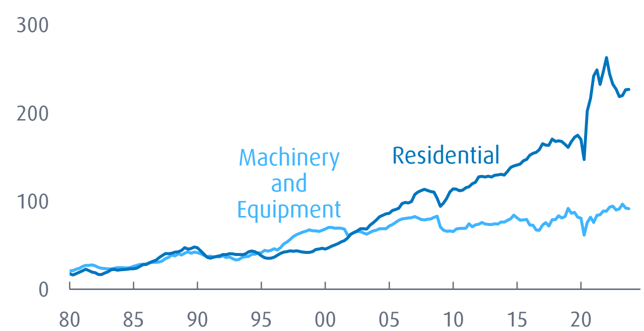
Canada (C$ blns : 4-qtr m.s.)
Net Flows



Sources: BMO Economics, Haver Analytics, Statistics Canada

Chart 5
Priorities, Priorities

Canada (C$ blns : s.a.a.r.)
Investment



Sources: BMO Economics, Haver Analytics, Statistics Canada force of a wave of Baby Boomers reaching retirement age. The part rate for those aged 15-64 has risen by roughly a point from 79% in 2017 to around 80% now. One of the specific goals of the Council was to boost the part rate of those over the age 55; instead, that group has seen a dip from just above 38% to just below 37%. An area of success over this period has been the participation rate for women aged 25 to 44; it rose 3 points to above 85%, helped by the focus on affordable child care.

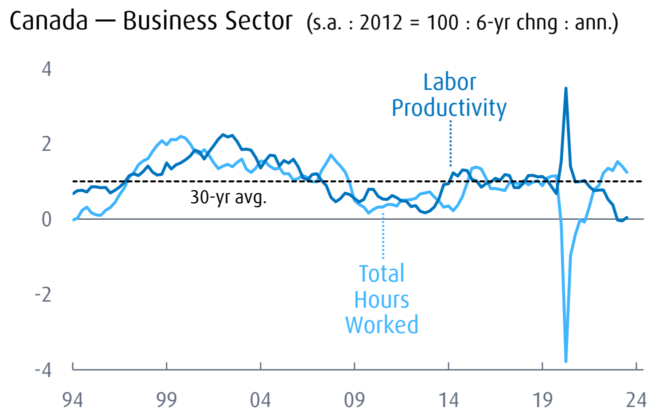
Note that the recommendations were generally careful not to push for big new bureaucracies, or large new government-funded programs. Yet, the reality is that **one of the fastest growing sectors in terms of jobs has been public administration**. Public sector payrolls have risen by 190,000 (or more than 17%) in just the six years since the report was published, with nearly half of those jobs in the federal government alone (a rise of more than 30%). As a share of overall payroll employment, public administration is now 7.2%, the highest of this century apart from the early pandemic distortion (*Chart 6*).

The rising share of public sector employment is likely doing no favours for Canada's weak productivity performance. The **Advisory Council had aimed its recommendations at lifting output per person**, with an eye on offsetting a looming decline in labour force participation in the coming years. In fact, **the opposite has happened since 2017**—productivity has essentially stalled out (growing just 0.2% annually since then), while hours worked have jumped amid the surge in population to an average annual growth rate of 1.3% (*Chart 7*). Ironically, while the Council fretted about Canada's potentially weak GDP growth rate of 1.5% over the next 50 years, the economy has in fact grown at precisely a 1.5% annualized pace since their report was published in late 2017.

Chart 6
Public Sector Payrolls: Plentiful

Sources: BMO Economics, Haver Analytics, Statistics Canada

Chart 7
Working Harder, Not Smarter



Sources: BMO Economics, Haver Analytics, Statistics Canada

Bottom Line: Canada's economy is mired in a long-term growth funk, which increasingly looks structural in nature. The most recent significant study on strengthening the long-term growth outlook has so far proven to be a damp squib. Simply, we need a serious rethink on proposals to lift productivity and growth. Given that Canada is plagued by weak capital spending and persistent direct investment outflows, we can conclude that at the very least competitive-crushing tax hikes should be considered a non-starter. And, if higher taxes are bad for investment and productivity, unpredictable taxes are likely even worse.

Table 1
Advisory Council on Economic Growth — Recommendations

1 Focus on productivity-enhancing infrastructure: establish a Canadian Infrastructure Development Bank; develop a federal infrastructure strategy	5 Build a high-skill and resilient workforce through the FutureSkills Lab
2 Attract foreign direct investment: create a national FDI strategy and FDI agency	6 Identify and target key sectors for growth
3 Attract talent through immigration: • Bring in an additional 75k permanent economic immigrants per year by 2021 • Streamline entry for senior and specialized talent • Qualify more international students for PR; improve accreditation standards	7 Broaden workforce participation
4 Use innovation to drive growth: • Focus on sectors/technologies that have momentum; create additional growth capital to help companies scale up • Incorporate innovation in government procurement policy; expand successful government innovation programs	8 Position Canada as a global trading hub: • Improve trade relations within North America and with large and fast-growing nations, especially China, Japan, and India • Develop "post-agreement" strategies to champion Canada and to support domestic businesses • Improve workforce resilience to changes from technology and international trade

[1] The Path to Prosperity: Resetting Canada's Growth Trajectory. https://www.budget.canada.ca/aceg-ccce/pdf/ideas-into-action-eng.pdf [^]

Economic Forecast Summary for March 8, 2024

	2023 Q1	2023 Q2	2023 Q3	2023 Q4	2024 Q1	2024 Q2	2024 Q3	2024 Q4	Annual 2022	Annual 2023	Annual 2024
CANADA											
Real GDP (q/q % chng : a.r.)	2.6	0.6	-0.5	1.0	1.5	0.5	1.5	2.0	3.8	1.1	1.0
Consumer Price Index (y/y % chng)	5.1	3.5	3.7	3.2	2.9	2.9	2.4	2.4	6.8	3.9	2.7
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 ($blns : a.r.)	-18.6	-27.0	-19.0	-6.5	-17.3	-22.8	-25.6	-26.2	-10.3	-17.8	-23.0
Interest Rates (average for the quarter : %)											
Overnight Rate	4.50	4.58	5.00	5.00	5.00	4.92	4.50	4.17	2.04	4.77	4.65
3-month Treasury Bill	4.39	4.54	5.02	5.01	4.90 ↓	4.80 ↓	4.45 ↓	4.15 ↓	2.17	4.74	4.60
10-year Bond	3.04	3.10	3.64	3.67	3.40 ↓	3.30	3.20 ↑	3.05 ↑	2.77	3.36	3.25 ↑
Canada-U.S. Interest Rate Spreads (average for the quarter : bps)											
90-day	-39	-72	-52	-51	-53 ↓	-66 ↓	-80 ↓	-59 ↓	9	-53	-64 ↓
10-year	-61	-50	-51	-77	-73 ↓	-76 ↓	-76 ↓	-75	-18	-60	-75 ↓
UNITED STATES											
Real GDP (q/q % chng : a.r.)	2.2	2.1	4.9	3.2	2.0	0.8	1.3	1.5	1.9	2.5	2.2
Consumer Price Index (y/y % chng)	5.7	4.0	3.6	3.2	3.1	3.0	2.8	2.7	8.0	4.1	2.9
Unemployment Rate (percent)	3.5	3.6	3.7	3.8	3.8 ↑	3.9	4.1	4.2	3.6	3.6	4.0
Housing Starts (mlns : a.r.)	1.39	1.45	1.37	1.48	1.40	1.40	1.40	1.41	1.55	1.42	1.40
Current Account Balance ($trlns : a.r.)	-0.86	-0.87	-0.80	-0.79	-0.80	-0.80 ↑	-0.81 ↑	-0.82 ↑	-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	5.25	4.75	2.08	5.28	5.20
10-year Note	3.65	3.59	4.15	4.44	4.15	4.05	3.95 ↑	3.80 ↑	2.95	3.96	4.00 ↑
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$/Euro	1.07	1.09	1.09	1.08	1.08	1.09	1.09	1.10	1.05	1.08	1.09
US$/£	1.22	1.25	1.27	1.24	1.27	1.27	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

Robert Kavcic
Senior Economist
robert.kavcic@bmo.com

Shelly Kaushik
Economist
shelly.kaushik@bmo.com

Quebec Budget
Tuesday

The **Province of Quebec** will table the 2024 budget on Tuesday, and expectations appear to be pointed toward a tougher fiscal picture. There are at least three big forces that we have been eying that are now playing out across the provincial landscape. First, softer economic growth and inflation are starting to bend the revenue growth curve down. That's especially true relative to baseline plans, which had been very easy to beat in recent years. Meantime, public-sector wage bills are now coming due after a period of outsized inflation, and Quebec's recent settlement is going to lift spending. At the same time, debt service costs are likely to creep steadily higher in the coming years. All told, don't be surprised if the FY24/25 budget balance (most recently pegged at a small $678 million deficit on a public accounts basis) deteriorates, and the return to surplus is delayed. Borrowing requirements look to rise in FY24/25, with a possibly larger deficit and increased maturities. It's also important to note that Quebec is hardly alone in these trends, as each province to table a 2024 budget so far has shown a weaker fiscal profile and an increase in borrowing. — R.K.

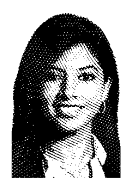
National Balance Sheet and Financial Flow Accounts (Q4)
Wednesday, 8:30 am

Growth in household disposable income eased in Q4 as a deceleration in wage gains was partially offset by a surge in rental and property income. Meantime, growth in mortgage demand slowed further amid elevated interest rates. Altogether, we expect household **debt-to-income** ratios to decline for a third straight quarter. Note that GDP revisions suggest that Q3's modest fall could be poised for a notable downward shift. While debt levels remain elevated, the declining trajectory points to some improvement for household finances. The same can't be said for governments, however: debt ratios have risen over the past two quarters and are poised to step up again in the short term as borrowing plans ramp up this budget season. — S.K.

United States

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

Jay Hawkins
Senior Economist
jay.hawkins@bmo.com



Priscilla Thiagamoorthy
Senior Economist
priscilla.thiagamoorthy@bmo.com

Consumer Prices
Tuesday, 8:30 am

Feb. (e)	**+0.4%**	**+3.1% y/y**
Consensus	*+0.4%*	*+3.1% y/y*
Jan.	+0.3%	+3.1% y/y

Ex. Food & Energy

Feb. (e)	**+0.3%**	**+3.7% y/y**
Consensus	*+0.3%*	*+3.7% y/y*
Jan.	+0.4%	+3.9% y/y

CPI inflation likely climbed 0.4% in February, up from January's already elevated 0.3% gain. If realized, this would mark the fastest monthly increase in consumer prices since last September. Leading the way are retail gasoline prices that rose 4.6% on average from January's level, according to AAA. Progress on inflation has been uneven across components with housing and core services inflation still rising at an elevated pace. On a brighter note, the ISM Manufacturing and Service PMIs' prices-paid indexes both fell in February, partially reversing January's sharp increase, suggesting a more mixed inflationary environment may be percolating under the surface. From a year ago, inflation is expected to hold at 3.1%.

Core inflation, excluding food and energy, is forecast to slow a tenth of a percentage point from January's pace to 0.3%. From a year ago, it should cool to 3.7% from 3.9% in January in part due to favourable base effects. Even so, core inflation is expected to remain well above the Fed's 2.0% target. In short, progress on inflation remains frustratingly slow, but continues. The Fed's March Beige Book noted cooling consumers as they appear to be increasingly price sensitive to discretionary goods. Unfortunately, it will likely take better inflation data to assure a majority of voting members on the FOMC that inflation is moving convincingly toward the target. — S.A.

Retail Sales

Thursday, 8:30 am

		Ex. Autos
Feb. (e)	**+0.5%**	**+0.3%**
Consensus	*+0.8%*	*+0.5%*
Jan.	-0.8%	-0.6%

Ex. Autos/Gas	
Feb. (e)	**+0.2%**
Consensus	*+0.3%*
Jan.	-0.5%

Retail sales growth is projected to rebound a solid 0.5% in February after plunging 0.8% in January. The bounceback will be partially driven by higher gas prices (up 4.4% last month) and auto sales, which improved to an annualized pace of 15.8 million units from 14.9 million in January (Ward's data). An as-expected increase in retail sales would push the year-on-year advance up to 2.3% from 0.6% in January. Retail sales ex autos are forecast to bounce back to 0.3% after declining 0.6% in the previous month, while sales ex. autos and gas are expected to rise 0.2% after falling 0.5% in January. — J.H.

Industrial Production

Friday, 9:15 am

	Industrial Production	Capacity Utilization
Feb. (e)	**unch**	**78.4%**
Consensus	*unch*	*78.4%*
Jan.	-0.1%	78.5%

Industrial production looks to remain unchanged in February, with the index unable to make any traction for a third straight month. Manufacturing output likely faltered as the production of consumer goods and business equipment sagged. Mining is expected to pick up as milder temperatures helped oil and gas extraction, while volatile utilities likely declined on less demand for heating. **Capacity utilization** looks to edge down 0.1 ppts to 78.4%. After peaking near 81% back in September 2022, the utilization rate is slowly trending down. Overall, industrial production continues to drift sideways with factories unlikely to make significant headway this quarter. — P.T.

Financial Markets Update for March 8, 2024

		Mar 8 [1]	Mar 1	Week Ago	4 Weeks Ago (basis point change)	Dec 31, 2023
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	4.92	4.90	2	-3	-12
	United States	5.38	5.37	1	1	5
	Japan	-0.06	-0.10	4	6	15
	United Kingdom	5.21	5.33	-12	-12	-12
	Australia	4.35	4.34	1	0	-1
2-Year Bonds	Canada	4.05	4.09	-4	-15	17
	United States	4.47	4.53	-6	-1	22
10-Year Bonds	Canada	3.35	3.43	-8	-19	24
	United States	4.09	4.18	-9	-8	21
	Japan	0.73	0.71	2	1	12
	Germany	2.27	2.41	-14	-11	25
	United Kingdom	3.98	4.11	-13	-10	45
	Australia	3.97	4.14	-17	-15	2
Risk Indicators	VIX	14.3	13.1	1.2 pts	1.4 pts	1.8 pts
	Inv. Grade CDS Spread [2]	50	52	-2	-4	-6
	High Yield CDS Spread [2]	329	336	-6	-20	-27
					(percent change)	
Currencies	US¢/C$	74.23	73.74	0.7	-0.1	-1.7
	C$/US$	1.347	1.356	—	—	—
	¥/US$	147.23	150.12	-1.9	-1.4	4.4
	US$/€	1.0946	1.0837	1.0	1.5	-0.8
	US$/£	1.286	1.266	1.6	1.8	1.0
	US¢/A$	66.25	65.27	1.5	1.5	-2.7
Commodities	CRB Futures Index	279.09	277.11	0.7	1.7	5.8
	Oil (generic contract)	78.26	79.97	-2.1	1.8	9.2
	Natural Gas (generic contract)	1.79	1.84	-2.2	-2.9	-28.6
	Gold (spot price)	2,174.47	2,082.92	4.4	7.4	5.4
Equities	S&P/TSX Composite	21,818	21,552	1.2	3.8	4.1
	S&P 500	5,165	5,137	0.6	2.8	8.3
	Nasdaq	16,259	16,275	-0.1	1.7	8.3
	Dow Jones Industrial	38,892	39,087	-0.5	0.6	3.2
	Nikkei	39,689	39,911	-0.6	7.6	18.6
	Frankfurt DAX	17,825	17,735	0.5	5.3	6.4
	London FT100	7,665	7,683	-0.2	1.2	-0.9
	France CAC40	8,034	7,934	1.3	5.0	6.5
	S&P ASX 200	7,847	7,746	1.3	2.6	3.4

[1] = as of 11:30 am *[2] = One day delay*

	Monday March 11	Tuesday March 12	Wednesday March 13	Thursday March 14	Friday March 15
China	CPI PPI **Feb. (e) +0.3% y/y -2.5% y/y** Jan. -0.8% y/y -2.5% y/y **Aggregate Yuan Financing [D]** **Feb. (e) 2.3 trln** Jan. 6.5 trln **New Yuan Loans [D]** **Feb. (e) 1.5 trln** Jan. 4.9 trln				
Japan	**Real GDP** **Q4 F (e) +0.3% +1.3% y/y** Q3 -0.8% +1.6% y/y **Machine Tool Orders** **Feb. P** Jan. -14.0% y/y				
Europe		**GERMANY** **Consumer Price Index** **Feb. F (e) +0.6% +2.7% y/y** Jan. -0.2% +3.1% y/y **UNITED KINGDOM** **Payrolls** **Feb.** Jan. +48k **Avg. Weekly Reg. Earnings (3m/3m)** **Jan. (e) +6.1% y/y** Dec. +6.2% y/y **Employment (3m/3m)** **Jan. (e) +10k** Dec. +72k	**EURO AREA** **Industrial Production** **Jan. (e) -1.5% -2.6% y/y** Dec. +2.6% +1.2% y/y **UNITED KINGDOM** **Monthly Real GDP 3m/3m** **Jan. (e) +0.1% -0.1%** Dec. -0.1% -0.3% **Index of Services 3m/3m** **Jan. (e) +0.2% unch** Dec. -0.1% -0.2% **Industrial Production** **Jan. (e) unch +0.7% y/y** Dec. +0.6% +0.6% y/y **Trade Deficit** **Jan. (e) £15.1 bln** Dec. £14.0 bln		**FRANCE** **Consumer Price Index** **Feb. F (e) +0.9% +3.1% y/y** Jan. -0.2% +3.4% y/y **ITALY** **Consumer Price Index** **Feb. F (e) +0.1% +0.9% y/y** Jan. -1.1% +0.9% y/y **Retail Sales** **Jan.** Dec. -0.1% +0.3% y/y
Other		**AUSTRALIA** **NAB Business Confidence** **Feb.** Jan. 1	**AUSTRALIA** **CBA Household Spending** **Feb.** Jan. +3.1% +3.6% y/y		

[D] = date approximate

Upcoming Policy Meetings | Bank of England: Mar. 21, May 9, June 20 | European Central Bank: Apr. 11, June 6, July 18

North American Calendar — March 11–March 15

Canada

Monday March 11

Manpower's Cdn. Employment Outlook Survey (Q2) expected within the next week

Tuesday March 12

Quebec Budget

10:30 am	3-, 6- & 12-month bill auction $24.0 bln (new cash $2.4 bln)
11:15 am	Cash management bond buybacks $0.5 bln

Wednesday March 13

8:30 am	**National Balance Sheet and Financial Flow Accounts (Q4)**

Thursday March 14

8:30 am	**Mfg. Sales**	**Mfg. New Orders**
Jan. (e)	**unch**	**-0.1%**
Consensus	*+0.3%*	*n.a.*
Dec.	-0.7%	+2.3%
8:30 am	**New Motor Vehicle Sales**	
Jan. (e)	**+17.0% y/y**	
Dec.	+16.3% y/y	
Noon	5-year bond auction $5.0 bln	

2-year bond auction announcement

Friday March 15

8:15 am	**Housing Starts**	
Feb. (e)	**230,000 a.r. (+3.0%)**	
Consensus	*215,000 a.r. (-3.8%)*	
Jan.	223,589 a.r. (-10.2%)	
8:30 am	**Wholesale Trade**	
Jan. (e)	**-0.6%**	
Dec.	+0.3%	
8:30 am	**Int'l Securities Transactions Inflows**	**Outflows**
Jan.		
Dec.	$10.4 bln	$29.4 bln

United States

Monday March 11

President Biden releases fiscal 2025 budget proposals

11:30 am	13- & 26-week bill auctions $149 bln
1:00 pm	3-year note auction $56 bln

Manpower's U.S. Employment Outlook Survey (Q2) expected within the next week

Tuesday March 12

6:00 am	**NFIB Small Business Economic Trends Survey**	
Feb. (e)	**90.2**	
Consensus	*90.6*	
Jan.	89.9	
8:30 am	**Consumer Prices**	
Feb. (e)	**+0.4%**	**+3.1% y/y**
Consensus	*+0.4%*	*+3.1% y/y*
Jan.	+0.3%	+3.1% y/y
8:30 am	**CPI ex. Food & Energy**	
Feb. (e)	**+0.3%**	**+3.7% y/y**
Consensus	*+0.3%*	*+3.7% y/y*
Jan.	+0.4%	+3.9% y/y
2:00 pm	**Budget Balance**	
Feb. '24 (e)	**-$305.0 bln[C]**	
Feb. '23	-$262.4 bln	
11:00 am	4-, 8- & 17-week bill auction announcements	
11:30 am	42-day cash management bill auction $80 bln	
1:00 pm	10[R]-year note auction $39 bln	

Wednesday March 13

7:00 am	**MBA 30-year FRM**
Mar. 8	
Mar. 1	7.02%
10:00 am	**Quarterly Services Survey (Q4 F)**
11:30 am	17-week bill auction
1:00 pm	30[R]-year bond auction $22 bln

Thursday March 14

8:30 am	**Initial Claims**	
Mar. 9 (e)	**216k (-1k)**	
Mar. 2	217k (unch)	
8:30 am	**Continuing Claims**	
Mar. 2		
Feb. 24	1,906k (+8k)	
8:30 am	**Retail Sales**	**Ex. Autos**
Feb. (e)	**+0.5%**	**+0.3%**
Consensus	*+0.8%*	*+0.5%*
Jan.	-0.8%	-0.6%
8:30 am	**Retail Sales ex. Autos/Gas**	
Feb. (e)	**+0.2%**	
Consensus	*+0.3%*	
Jan.	-0.5%	
8:30 am	**PPI Final Demand**	
Feb. (e)	**+0.3%**	**+1.0% y/y**
Consensus	*+0.3%*	*+1.0% y/y*
Jan.	+0.3%	+0.9% y/y
8:30 am	**PPI Final Demand ex. F&E**	
Feb. (e)	**+0.3%**	**+1.9% y/y**
Consensus	*+0.2%*	*+1.8% y/y*
Jan.	+0.5%	+2.0% y/y
10:00 am	**Business Inventories**	
Jan. F (e)	**+0.2%**	
Consensus	*+0.2%*	
Jan. P	unch	
Dec.	+0.3%	
11:00 am	13-, 26- & 52-week bill, 20[R]-year bond, 10[R]-year TIPS auction announcements	
11:30 am	4- & 8-week bill auctions	

Friday March 15

8:30 am	**Import Prices**	
Feb. (e)	**+0.2%**	**-0.9% y/y**
Consensus	*+0.2%*	*-0.9% y/y*
Jan.	+0.8%	-1.3% y/y
8:30 am	**Empire State Manufacturing Survey**	
Mar. (e)	**-5.0**	
Consensus	*-7.0*	
Feb.	-2.4	
9:15 am	**Industrial Production**	**Capacity Utilization**
Feb. (e)	**unch**	**78.4%**
Consensus	*unch*	*78.4%*
Jan.	-0.1%	78.5%
10:00 am	**University of Michigan Consumer Sentiment**	
Mar. P (e)	**77.4**	
Consensus	*77.3*	
Feb.	76.9	

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

Upcoming Policy Meetings | Bank of Canada: Apr. 10, June 5, July 24 | FOMC: Mar. 19-20, Apr. 30-May 1, June 11-12

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