Focus

Feature Article

Where's the Recession?

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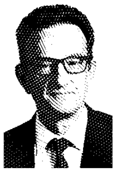
Fed Policy Preview: A Hawkish Pause



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After 10 consecutive rate hikes over 15 months for a total of 500 bps, the **FOMC is expected to pause on June 14**. However, this hold won't herald a stop or even a multi-meeting hiatus. We view it as a requisite recalibration of the tightening cadence given where policy rates are now positioned. As argued below, if the objective is still restoring price stability while minimizing the risk of a deep economic downturn (and hoping for that elusive 'soft landing'), then rate hikes should shift into a more cautious cadence. And, if moving in even smaller increments isn't on the table, then this means skipping a meeting while keeping a quarter-point tempo.

A potential pause was signalled last meeting (May 3), with the FOMC altering its **forward guidance**. The policy statement said: "*In determining the extent to which additional policy firming may be appropriate to return inflation to 2 percent over time, the Committee will take into account the cumulative tightening of monetary policy, the lags with which monetary policy affects economic activity and inflation, and economic and financial developments*". The first part of the phrase replaced March's line that *"the Committee anticipates that some additional policy firming may be appropriate…"*.

The Fed shifted from anticipating further rate hikes to sounding uncertain about them. The more conditional language suggested a pause could occur in June just as easily as another rate hike. Indeed, **we reckon this guidance will be repeated, this time to signal a resumption of rate hikes next month.**

Policy is at a critical point… With the fed funds target range sporting 5-handles (5.00%-to-5.25%) and the latest yearly PCE inflation readings sporting 4-handles (total 4.4%, core 4.7% and supercore 4.5%), **real policy rates are now, unequivocally, in positive territory**. Policy has definitively shifted from decreasing an economic tailwind (which is still tightening) to now **nurturing an economic headwind**.

However, during the past 15 years (since April 2008), the economy has had positive real policy rates (employing the core PCE) for only a 15-month period during the 2018-19 interval, which was at the end of the tightening cycle that started very slowly in December 2015. As 2018 unfolded and core PCE inflation was showing consistent readings in the 2.0%-to-2.1% range, the Fed became increasingly concerned about further acceleration and pushed nominal policy rates above inflation to tamp down inflation pressures but not to the point of triggering a recession.

By the time real rates were peaking just above 0.70% during the spring of 2019, the data casualties were mounting. For example (among some of the NBER's recession-defining indicators), real PCE plummeted 0.8% in December 2018 (a plunge surpassed only around the past three recessions), payroll employment contracted in February 2019, and household employment contracted in three of the four months ending April 2019 as did industrial production. In the wake of the weakening economic data that proved the power of even modestly positive real rates, and not wanting to trigger a recession, the Fed eased by 75 bps during the August-October interval. This pulled real rates back down to around zero.

In April 2023 (again, employing the core PCE), the real policy rate was 0.18% with the Fed raising nominal rates another 25 bps in May. **History would dictate caution at this juncture.** Meanwhile, a pause permits a bit more time for the 500 bp cumulative tightening to continue working its way through the economy. After all, this was the largest and fastest total hike since the Fed began targeting the fed funds rate in the 1980s. Working their way through are also $782 billion in total quantitative tightening and the recently reemphasized bank credit tightening trend.

Too early to stop... While a pause appears to be warranted at this point, a stop does not. Headline and underlying PCE inflation rates in the 4% range are still well above the 2% target. And with the three-month annualized changes for the core and supercore also sporting 4-handles, underlying inflation seems sticky in that range. That reflects still-elevated wage growth resulting from a still-sturdy and tight labour market.

Payroll jobs jumped by 339k in May, with the three-month average gain (283k) marking its eighth consecutive month in the 250k-to-350k range (i.e., still sturdy). Indeed, a jump in April job openings showed that labour demand (payrolls + openings) hit a new record high after dropping in each of the three prior months. The unemployment rate rose three-tenths to 3.7% in May, but this is below the Fed's 4.0% longer-run level (i.e., still tight). Meanwhile, average hourly earnings increased 0.3%, with the yearly change dipping a tenth to 4.3% y/y and the three-month change drifting up two-tenths to 4.0% annualized (i.e., still elevated). Given this inflation-labour market mix, more tightening—arguably served more cautiously—is still required to slacken the labour market and, in turn, rein in wage growth and underlying PCE inflation.

Indeed, given the need to tighten more, **there's a chance we could get at least one hawkish dissenter** on June 14 favouring a continuation of quarter-point rate hikes instead of a pause. Note that the market is currently pricing in a 34% chance of a rate hike this month and 89% odds of one next month.

Finally, in the **Summary of Economic Projections (SEP)** and the 'dot plot', we expect the median fed funds forecast to increase by 25 bps to 5.375% for this year, consistent with another rate hike. It will take only 3 of 10 participants who wrote in 5.125% for the March SEP to lift their projections and turn the median dial by a quarter point. (It would take only two to turn the dial by half a hike.) Also, in March's survey, the policy hawks became more hawkish, a trend we expect to continue. The March SEP had four forecasts of 5.625% or higher (one at 5.875%), double the number from before (none at 5.875%). **We expect to see a '6 handle' for the first time.**

For 2024, the median forecast had been 4.25%, between the nine participants at 4.125% or lower and the nine at 4.375% or higher. We reckon the balance will tip to the latter side, with the median forecast increasing by at least 12½ bps. Although rate cuts should still be the theme for the year, **rate levels are going to be averaging higher for longer through to 2025**.

Elsewhere, for the past two SEPs, the FOMC had revised down the median projection for real GDP growth and revised up the forecast for core PCE inflation for both 2023 and 2024. This acknowledged the **stubbornness of inflation and the necessity of more growth-dampening tightening to rein it in**. The March results (Q4/Q4) were 0.4% and 1.2%, respectively, for GDP, and 3.6% and 2.6% for the core PCE price index. We wouldn't be surprised to see a bit more of this revision theme for this year, but not for next year. Our current forecast is 0.3% and 1.9%, respectively, for GDP, and 3.9% and 2.4% for the core PCE price index.

U.S. Economy: Flow of Resilience

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The current cycle isn't tracking the usual playbook, whereby higher interest rates cause financial conditions to weaken and the economy to buckle. As discussed in this week's *Feature*, one reason recession calls keep getting pushed out is the large number of buffers that are currently supporting activity, including excess savings, revenge spending, and labour hoarding. This week, another report landed on the table, highlighting an additional source of resilience for the U.S. economy: **solid balance sheets**.

The Fed's **Flow of Funds Accounts** provide a quarterly snapshot of the financial position of households and businesses. In Q1, the net worth of households (and nonprofit organizations) turned up for a second straight quarter, by a hefty $3 trillion or 2.1%, as rising equity markets more than offset a dip in home values. And, with equities entering a new bull market this week (the S&P 500 index pushed 20% above its October low) and home prices turning higher, there is a good chance that net worth returned to its all-time peak set before the Fed began cranking rates.

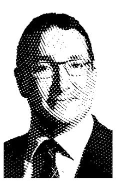
More wealth will give consumers an incentive to spend, but they also need firepower. Not to worry, households are sitting on a **massive cache of liquid assets**, with demand deposits and currency holdings $3.3 trillion (or 276%) above pre-pandemic levels. While deposits have leaked out of savings accounts, some have flowed into money market funds that ballooned during the tightening cycle. These funds can also be readily tapped to support spending.

Meantime, on the liability side, **household debt has levelled off** at 100% of disposable income, well below the peak (136%) reached before the financial crisis. Although higher interest rates have sapped the incentive to borrow, many households are at least capable of doing so to keep spending.

Business balance sheets are also in generally good shape. Nonfinancial corporate debt, as a per cent of assets, is lower than before the pandemic and near a four-decade norm. Debt growth has trended around 6% in the past year, only modestly higher than usual. Net worth is also trending higher. This positive financial picture applies to nonfinancial unincorporated businesses as well.

Sturdy balance sheets are one more reason the Fed may need to work overtime this cycle to restore price stability. And, it's this threat that risks overwhelming all the pillars of resilience once they fade, leading to a hard landing for the economy.

Bank of Canada Back in Tightening Mode



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The Bank of Canada came off the sidelines with a 25 bps rate hike this week, bringing policy rates up to 4.75%, the highest since 2001, following a 5-month hiatus. Markets went into the meeting priced 50/50 between a 25 bp hike and no move, highlighting the uncertainty. The hike was accompanied by a **hawkish statement**, suggesting that the Bank isn't satisfied with just the latest 25 bp move. Indeed, if "*monetary policy was not sufficiently restrictive*" after 425 bps of hikes, it's hard to believe that another 25 bps will do the trick. Accordingly, **we're forecasting that the BoC will raise rates another 25 bps at the next meeting on July 12**.

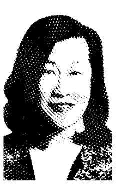
The **major driver** of this week's move was the stronger-than-expected **Q1 GDP** report. Growth came in above the BoC's April forecast, and it looks as if there's more momentum than anticipated heading into Q2. The bounceback in the housing market also appears to have struck a nerve. Policymakers have been counting on a slowing economy to bring inflation back down to target, but things have yet to evolve in that direction amid consumer-driven resilience.

As always, **inflation** was a big part of the policy statement, with the Bank continuing to expect the headline rate to slow to 3% in the coming months. However, the BoC noted that short-term core inflation metrics have been sticky in the 3.5%-to-4% range. That was paired with "*excess demand persisting*", which brings things back to the firmer growth profile noted above. Indeed, inflation alone likely wasn't enough to prompt the BoC to hike, as Governor Macklem downplayed the April inflation uptick, noting later that week that the broader trend was slowing. The Q1 GDP beat, keeping the output gap in positive territory, looks like it was the clincher for this week's move.

Looking ahead to the July policy announcement, there's only a handful of top-tier data releases until then. We get one CPI, one jobs, and one monthly GDP report, along with the latest Business Outlook Survey. While the BoC was likely very focused on the quarterly GDP report, the **monthly GDP** figures don't have the same importance. In addition, April was restrained by a public sector strike, leaving underlying growth with more momentum than the headline suggests. The **CPI** report likely won't move the needle either, as one month of improvement isn't enough to put policymakers' inflation worries at ease. The **jobs** report has the potential to move the needle, if we get another weak print in June after the modest softening seen in May. Finally, the **Business Outlook Survey** also has the potential to sway the BoC, as it pays close attention to inflation expectations in the survey, as well as the outlook for activity. All told, **any individual piece of data likely isn't enough to derail an expected July hike**. Unless we get a uniformly bad run of data, policy rates are like to have a 5-handle for the first time in over two decades when the Bank meets next month.

Key Takeaway: The firmer growth backdrop prompted the Bank of Canada to tighten further with a 25 bp hike this week, pushing rates to 4.75%. We expect another 25 bp hike in July, with only limited data over the coming weeks to derail that outcome. The BoC is expected to pause again thereafter, but risks remain skewed toward higher rates until the economy slows and inflation moves definitively toward 2%.

ECB and BoJ... Divergence Continues



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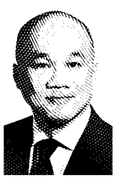
We know what the goal is—2% inflation—but there are a few paths to get there. There are a couple of central banks that had been hiking rates, then took a break, realized they didn't like what they saw, and resumed hiking again. Then there are some central banks that are on a one-way road to 2% and will aim to get there, come hell or high water.

The **ECB** is one. It has hiked rates for seven meetings in a row, for a total of 375 bps, and it is a given that another 25 bp hike is coming on June 15. The central bank is still hawkish, although some members are moreso than others. It was crystal clear from the Minutes to the May meeting that inflation is the single biggest problem for the Governing Council, and was "*broadly seen as worrisome*". A wage-price spiral was even alluded to, as well as elevated profits. "*If wages were chasing prices and profits* *were chasing wages, this could be an explanation for the increased persistence of high inflation."* It is unlikely that we will see a larger rate hike as both headline and core inflation have finally cooled more meaningfully in the latest month; the latest ECB Consumer Expectations Survey showed that inflation expectations three years out "*decreased significantly";* and, the Euro Area is now in a technical recession. We are also looking for a similar move in July and continue to believe that the September decision is too far out to make a call. In fact, there was a "*strong preference against returning to outright forward guidance*" at the last meeting, so we'll have to watch the data and wait.

Meantime, the **BoJ** has gone in the other direction and continues to stand by its ultra-easy monetary policy stance. In fact, Governor Ueda played the patience card recently with his reminder that "*it takes time for the impact of monetary policy to appear*"; and, though there was no time frame in mind to hit the 2% inflation target, it would not take over ten years. (Was he joking?) However, the Governor is aware that core CPI is at four-decade highs, and admitted that there is a "*not zero*" risk of getting the inflation forecast wrong. At the same time, "*there is also the risk of prematurely doing a rate hike"*. However, there is one positive takeaway that he pointed out: that wages were rising "*to secure talent*". And that is not a bad thing.

Crude Oil Outlook: Fear versus Fundamentals



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These are perplexing days for the oil market as benchmark crude prices have not responded to Saudi Arabia's unilateral decision last weekend to cut production by a hefty 1.0 mb/d (or ~1% of global oil supply). For now, it appears that fears over a (major) global economic downturn and, in turn, weaker global oil demand are offsetting any lift from the supply cut. Although we also remain concerned about the near-term economic outlook, we have been surprised by the extent of the pullback in prices so far this year. Consequently, **we have revised our annual WTI forecast to $78/bbl (previously $85) for 2023** but kept it at $80 for 2024. Note, at the beginning of the year we were projecting WTI to average $90.

We still think **crude oil prices will eventually regain some (modest) upward momentum in the second half of the year**, as, barring a major global recession, evolving supply/demand dynamics should lead to a tighter market balance (i.e., small deficit). The key factor that is expected to underpin a tighter oil balance revolves around OPEC+'s commitment to curtail production. The fact that Saudi Arabia, the most important member of the cartel, recently decided to cut production highlights how important higher prices are to the Kingdom's leadership. As we have often mentioned, Riyadh needs higher crude oil prices to pay for its economic diversification drive (i.e., building massive giga-projects aimed at boosting tourism and entertainment offerings). It bears mentioning that the IMF recently estimated that Saudi Arabia's fiscal breakeven oil price stands at $81 for 2023 and $75 for 2024.

However, the fact that the cartel has been forced to scale back production of late cannot necessarily be viewed as a clear-cut positive development. Recall OPEC+ also made big cuts totalling 2.0 mb/d and 1.7 mb/d, respectively, in October and April. The accumulation of such cuts suggests that **the recovery in global oil demand is proving weaker than initially anticipated**, likely reflecting the slow return to in-person work, still-sluggish overseas tourism and increasing EV adoption. Interestingly, last month the International Energy Agency (IEA) actually revised up its annual projection for global oil demand by 200 kb/d to an average of 102 mb/d for 2023 (vs. 98.8 mb/d in 2022). Although the IEA's projection may not be met, we'd be surprised if global oil demand experienced an outright contraction this year.

Key Takeaway: The fundamentals for an eventual turnaround in crude oil prices remain intact, namely: declining supply, rising demand and relatively low global inventories. However, we cannot deny the possibility that prices may continue to languish until it's clear that the developed economies can avoid a hard landing and, in tandem, that China's post-pandemic recovery has firmly taken hold.

Conversely, what's become increasingly apparent is that last year's boom in prices, when WTI approached $125 following Russia's invasion of Ukraine, was likely a temporary phenomenon. With OPEC+ now forced to scale back production rapidly, fears that non-OPEC+ suppliers had been under-investing in crude oil exploration and production following the sharp 2014 price correction can be set aside for now. Perhaps the bigger long-term issue for oil market participants revolves around 'peak oil demand', as more countries inevitably fast-forward the electrification process.

Recap

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

	Good News	Bad News
Canada ▪ BoC hikes 25 bps to 4.75%, the highest since 2001 ▪ BoC Dep. Gov. Beaudry: long-term real rates may remain elevated ▪ Wildfires in eastern Canada damage critical infrastructure	**Merchandise Trade Surplus** widened to $1.9 bln (Apr.) **Capacity Utilization** +0.1 ppts to 81.9% (Q1)	**Employment** -17,300 (May) **Jobless Rate** +0.2 ppts to 5.2% (May) **Average Hourly Wages** +5.1% y/y (May) **Labour Productivity** -0.6% (Q1) **Building Permits** -18.8% (Apr.) **Ivey PMI** -3.3 pts to 53.5 (May)
United States ▪ FOMC on deck next week ▪ S&P 500 pushes into bull-market territory	**Global Supply Chain Pressure Index** -0.36 pts to -1.71 (May)—record low **Household Net Worth** +$3.0 trln to $148.8 trln (Q1) **Consumer Credit** +$23.0 bln (Apr.)	**ISM Services PMI** -1.6 pts to 50.3 (May) **Factory Orders** +0.4% (Apr.)—below expected **Goods & Services Trade Deficit** widened to $74.6 bln (Apr.) **Initial Jobless Claims** +28k to 261k (June 3 week)
China ▪ PBoC Governor Yi Gang downplays sluggish inflation	**Caixin Services PMI** +0.7 pts to 57.1 (May) **Foreign Reserves** steady at $3.2 trln (May)	**Exports** -7.5% y/y; **Imports** -4.5% y/y (May) **Consumer Prices** +0.2% y/y; **Producer Prices** -4.6% y/y (May)—deflation concerns
Japan ▪ Economy grows faster than expected amid chatter of early elections ▪ BoJ on deck next week	**Real GDP** revised up to +0.7% q/q (Q1)—and Q4 is no longer negative	**Household Spending** -4.4% y/y (Apr.)
Europe ▪ Euro Area economy saw a mild downturn last winter ▪ ECB on deck next week ▪ Opinion polls show PM Sunak losing ground	**Euro Area—Producer Prices** slowed to +1.0% y/y (Apr.) **Germany—Trade Surplus** grew to €18.4 bln (Apr.) **Italy—Retail Sales** +0.2% (Apr.)	**Euro Area—Real GDP** revised down to -0.1% q/q (Q1) **Euro Area—Retail Sales** unch (Apr.) **Germany—Industrial Production** +0.3% (Apr.) —below expected **Germany—Factory Orders** -0.4% (Apr.) **France—Trade Deficit** widened to €9.7 bln (Apr.) **Italy—Industrial Production** -1.9% (Apr.)
Other ▪ RBA hikes 25 bps to 4.10% and signals more to come ▪ RBI on hold ▪ Oil prices gain little traction on Saudi Arabia's pledge to cut output		**Australia—Real GDP** slowed to +0.2% q/q (Q1) **Australia—Trade Surplus** narrowed to A$11.2 bln (Apr.)

Where's the Recession?

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The conventional wisdom for much of the past year has been that the North American economy has punched a one-way ticket to recession. But heading into the summer, growth on both sides of the border is holding up well, and expectations for a downturn continue to get pushed out. This is impressive resilience for two economies that have been subject to the most aggressive and abrupt tightening cycle since the 1980s. Let's look at some of the reasons why, and where we might go from here.

It's Just Too Soon

Yield curve predictions take time: Financial markets have been signalling the risk of a downturn, most vividly through an inverted yield curve which has a long and respected history of accurately foreshadowing downturns. Looking at the 10-year minus fed funds curve, inversion first occurs, on average, just over 14 months before the start of recession (with a range of 8-to-20 months) dating back to the late 1960s. Peak inversion occurs roughly six months before the onset of recession (*Table 1*). **Given that the curve first inverted in November 2022**, and if the May depths hold, **that would place the crosshairs of recession somewhere around the end of the year**—later than many initially expected, but not out of line with historical norms.

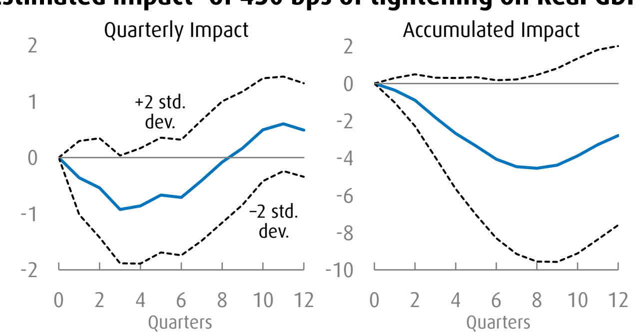
Monetary policy lags: It's well known that monetary policy acts with 'long and variable lags', and it's possible that rate hikes—which were at their most aggressive last summer—haven't worked fully through the system yet. Recent commentary from Federal Reserve officials reiterates that it has historically taken about 18 months for the full effect of rate hikes to be felt; but there is also some evidence that the lag is shortening to somewhere closer to 12 months. Our own modelling of the Canadian economy largely agrees with that broad view. That is, **the incremental impact of higher short-term interest rates is largest in the subsequent few quarters**, but the **cumulative impact doesn't max out until about 18 months down the road** (*Chart 1*). That's consistent with some sectors (i.e., housing) cracking early, but the full impact on the economy not being felt until late this year.

Table 1
Give Me Time
U.S. — Yield Curve[1] Lead Time to Recession (months)

	Inversions		Recession	Lead Times	
	First	Deepest	Start	First	Deepest
1969	Apr '68	Aug '69	Dec '69	20.3	4.1
1973	Mar '73	Sep '73	Nov '73	8.2	2.0
1980	Sep '78	Oct '79	Jan '80	16.2	3.1
1981	Oct '80	Jan '81	Jul '81	9.1	6.0
1990	Jan '89	Jun '89	Jul '90	18.2	13.2
2000	Apr '00	Dec '00	Mar '01	11.1	3.0
2007	Jul '06	Mar '07	Dec '07	17.3	9.2
Current	Nov '22	May '23	t.b.d.	t.b.d.	t.b.d.
			Average	**14.3**	**5.8**

Note: 2020 inversion left out due to pandemic
[1] 10-year treasury note yield less Fed Funds
Sources: BMO Economics, Haver Analytics, FRB

Chart 1
Long and Variable Lags
Canada (percent)
Estimated impact[1] of 450 bps of tightening on Real GDP



[1] VAR model for the Canadian economy covering the period 1982 to 2019
Sources: BMO Economics

There Are Big Buffers in Place

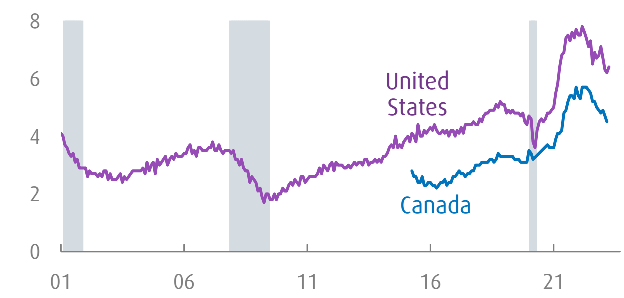
Excess demand for workers: Policymakers have a lot of excess demand to cut through before getting to the economy's bone, and the labour market is a good example. Job vacancy rates in both Canada and the U.S. surged to unprecedented highs last year (*Chart 2*). After some pullback recently, vacancy rates today remain well above pre-COVID norms, or even past late-cycle norms. In Canada, there was roughly one vacant job available for every unemployed person before rate hikes began, an unprecedented level of tightness. That said, there are **signs that momentum on this front is ebbing**, perhaps reflecting early impacts of monetary tightening. But, there is still a long way to go before the Fed and BoC start creating slack in the labour market.

Household savings cache: Households also **accumulated significant savings** through the pandemic, the result of steady job markets across most sectors, limited spending on travel and services, and fiscal transfers that ran well in excess of lost disposable income. The result is that household savings in excess of the pre-COVID baseline topped 10% of GDP, with much of that finding its way into a cache of deposits (*Chart 3*). Those deposits have more recently been drawn down (likely in part reflecting a shift to higher-yielding GICs and money market funds), but they highlight the economic buffer in place.

Mortgage market mechanics: Higher interest rates have already triggered home price corrections, but there hasn't been a major economic spillover yet. In the U.S., it's relatively straightforward—most pandemic boom-era buyers locked into long-term ultra-low fixed mortgage rates. **In Canada, rather than seeing payments on variable-rate mortgages rise in real time, the majority are instead seeing amortizations stretch out.** This is a subtle but very important feature that has taken what would otherwise be a significant and immediate shock, and spread it out over a number of years as these mortgages trickle into renewals. Indeed, the Bank of Canada estimates a steady climb in the share of mortgages subject to higher payments through the end of 2026 (*Chart 4*). There's no doubt that this will pose a stiff headwind, but it's far less acute than if a large swath or mortgages were seeing payments jump in real time with rate hikes. And let's not forget that most have been stress tested to handle these rates.

Chart 2
Excessive Excess Demand

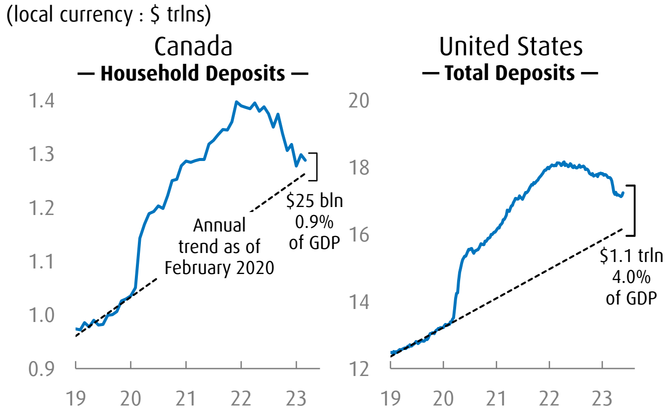
(percent)
Job Vacancy Rate



Shading marks U.S. recessions
Sources: BMO Economics, Haver Analytics, Statistics Canada, BLS

Chart 3
Cash Cushion

(local currency : $ trlns)

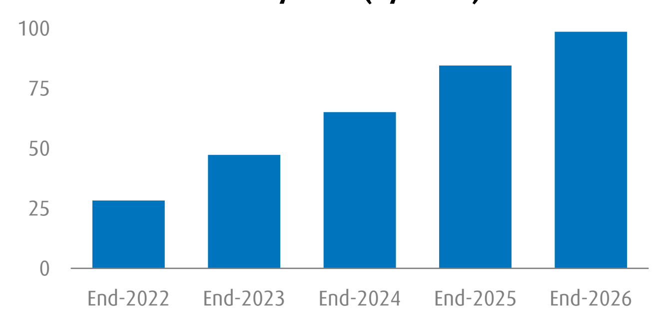


Sources: BMO Economics, Haver Analytics, OSFI, Statistics Canada, FRB, BEA

Chart 4
Stiff Headwind, Not a Hammer

Canada (percent)

Cumulative Share of Mortgages Subject to Payment Increase versus February 2022 (by count)



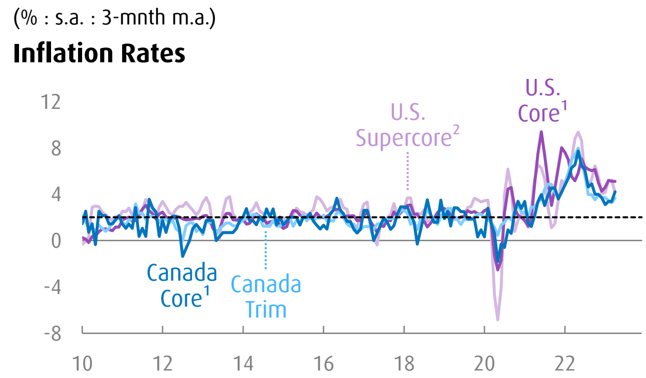
Sources: BMO Economics, Bank of Canada Financial System Review, May 2023

Policy Might Not Be Tight Enough

Inflation is proving to be sticky: Central banks are finding that **returning inflation to target is proving to be a challenge after some quick early gains**. Core inflation trends in North America have certainly cooled, from 3-month annualized run rates in the 6%-to-8% range this time a year ago, but they are now collectively settling around 4% (*Chart 5*). And, it hardly matters what measure of core one looks at—ex-food & energy, trim or even the stripped down Fed-favourite 'supercore'. At the same time, housing markets caught a bid in the spring, and if the most rate-sensitive sector of the economy is gaining momentum, maybe that's telling. **Fiscal policy** also remains incrementally stimulative and inflationary.

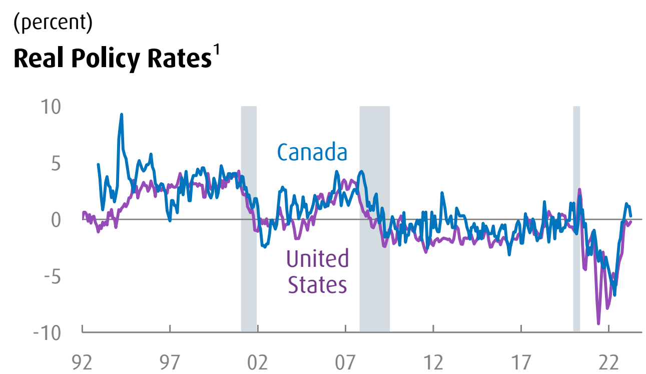
Real rates aren't *really* that high: If 2% inflation is the goal, but evidence continues to show that 4% is the reality, **the economy either needs more time for past rate hikes to work, or policy simply isn't tight enough**. Indeed, if underlying core inflation is now trending around 4% (somewhat higher in the U.S.), real policy rates have now moved back into positive territory, but not by a wide margin with the BoC at 4.75% and the Fed at 5%-to-5.25% (*Chart 6*). That is now near the slightly positive real rates seen at the tail end of the pre-COVID cycle, but that was arguably an era of disinflationary pressure and suppressed post-GFC rates that no longer exists. Cycles prior to that one (e.g., late-1990s and mid-2000s) saw real rates move into the 2%-to-4% range before the economy ultimately rolled over. That's certainly not to say that we need to see another 200 bps of tightening, but real rates might need to drift up somewhat further through a combination of more disinflation, and incrementally more tightening. The Bank of Canada seems to agree by tightening in June.

Chart 5
Stubborn Inflation



[1] ex. food & energy; [2] ex. energy, rent of primary residence & OER
Sources: BMO Economics, Haver Analytics, Statistics Canada, BEA

Chart 6
Is Policy *Really* Tight Enough?



Shading marks U.S. recessions; [1] policy rate minus annualized 3-month percent change in CPI ex. food and energy
Sources: BMO Economics, Haver Analytics, Statistics Canada, BoC, FRB, BLS

Key Takeaway

Monetary policy tightening takes time to work, and it is working… gradually. Keep in mind that **this tightening cycle started from an exceptionally stimulative level, and the economy may have some extra buffers built in**. That said, real policy rates have now crept into positive territory, which is a critical checkpoint, but it's entirely possible that policy just hasn't become quite tight enough, for long enough, yet. We saw the Bank of Canada give a nod in this direction when it raised rates again on June 7th; and we suspect both the BoC and Fed have some more work to do, even if the latter pauses on June 14th. For the economy, this is still a lot of tightening to swallow, and **the risk of a downturn remains in place**—for later this year.

Economic Forecast Summary for June 9, 2023

	2022				2023				Annual		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	2022	2023	2024
CANADA											
Real GDP (q/q % chng : a.r.)	2.6	3.6	2.3	-0.1	3.1	0.8	-0.5	-0.5	3.4	1.3	1.0
Consumer Price Index (y/y % chng)	5.8	7.5	7.2	6.7	5.1	3.7	3.4	3.0	6.8	3.8	2.5
Unemployment Rate (percent)	5.7	5.1	5.1	5.1	5.0	5.2	5.5	5.7	5.3	5.4 ↑	5.5
Housing Starts (000s : a.r.)	243	270	281	259	223	249	230	220	263	230	220
Current Account Balance ($blns : a.r.)	15.7	19.3	-39.3	-32.2	-24.7	-33.9	-38.3	-43.4	-9.1	-35.0	-50.0
Interest Rates (average for the quarter : %)											
Overnight Rate	0.33	1.17	2.75	3.92	4.50	4.58 ↑	5.00 ↑	5.00 ↑	2.04	4.77 ↑	4.38 ↑
3-month Treasury Bill	0.39	1.43	2.91	3.96	4.39	4.55 ↑	5.00 ↑	5.05 ↑	2.17	4.75 ↑	4.45 ↑
10-year Bond	1.92	2.98	3.01	3.16	3.04	3.10	3.40	3.30 ↑	2.77	3.20	3.10 ↑
Canada-U.S. Interest Rate Spreads (average for the quarter : bps)											
90-day	9	33	16	-22	-39	-74 ↑	-58 ↑	-62 ↑	9	-58 ↑	-75 ↑
10-year	-2	5	-10	-67	-61	-48 ↓	-36 ↓	-35 ↓	-18	-45 ↓	-32 ↓
UNITED STATES											
Real GDP (q/q % chng : a.r.)	-1.6	-0.6	3.2	2.6	1.3	1.0	-0.5	-0.5	2.1	1.3	1.0
Consumer Price Index (y/y % chng)	8.0	8.6	8.3	7.1	5.8	4.1 ↓	3.5 ↓	3.3 ↓	8.0	4.1 ↓	2.8 ↑
Unemployment Rate (percent)	3.8	3.6	3.5	3.6	3.5	3.6	3.9	4.4	3.6	3.8	4.4
Housing Starts (mlns : a.r.)	1.72	1.64	1.45	1.41	1.38	1.38	1.34	1.35	1.55	1.36	1.41
Current Account Balance ($trlns : a.r.)	-1.12	-0.95	-0.88	-0.83	-0.87	-0.90	-0.91	-0.92	-0.94	-0.90	-0.93
Interest Rates (average for the quarter : %)											
Fed Funds Target Rate	0.21	0.96	2.63	3.79	4.63	5.04	5.38	5.38	1.90	5.10	4.92
3-month Treasury Bill	0.30	1.10	2.75	4.18	4.78	5.25 ↓	5.60 ↓	5.65 ↓	2.08	5.35 ↓	5.20 ↓
10-year Note	1.94	2.93	3.11	3.83	3.65	3.60 ↑	3.80 ↑	3.65 ↑	2.95	3.65 ↑	3.40 ↑
EXCHANGE RATES (average for the quarter)											
US¢/C$	79.0	78.4	76.6	73.7	74.0	74.2	75.2	76.5	76.9	75.0	77.7
C$/US$	1.27	1.28	1.31	1.36	1.35	1.35	1.33	1.31	1.30	1.33	1.29
¥/US$	116	130	138	141	132	137	137	133	131	135	128
US$/Euro	1.12	1.06	1.01	1.02	1.07	1.09	1.10	1.12	1.05	1.10	1.14
US$/£	1.34	1.26	1.18	1.17	1.22	1.25	1.26	1.27	1.24	1.25	1.28

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

Canada

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National Balance Sheet and Financial Flow Accounts (Q1)

Wednesday, 8:30 am

Household disposable income fell in Q1 amid a decline in government transfers, slowing the pace of annual growth, while debt levels were steady as the Bank of Canada hiked rates once in the quarter before pausing. On net, the **household debt-to-income** ratio likely edged down for the second straight quarter on a non-seasonally adjusted basis. The seasonally adjusted ratio looks to be little changed, after dropping almost four ppts in Q4. Meantime, the bottoming-out of the housing market likely put a floor on the decline in the value of household assets, which should slow the increase in the debt-to-asset ratio. Looking ahead, the housing market's recovery likely pushed up mortgage demand in Q2, but the Bank's resumption of tightening could weigh in the following quarters.

Existing Home Sales

Thursday, 9:00 am

	Existing Home Sales	Average Prices
May (e)	**+4.0% y/y**	**+1.5% y/y**
Apr.	-19.5% y/y	-3.9% y/y

	MLS Home Price Index
May (e)	**-9.0% y/y**
Apr.	-12.3% y/y

The **housing** market picked up steam in May with all major cities posting big monthly sales increases, and some—including Toronto and Vancouver—rising above year-ago levels at double-digit rates. We expect annual growth in national sales to also flip signs, jumping to +4%. Average prices also look to rise 1.5% y/y, and we expect the decline in the quality-adjusted MLS HPI to moderate to 9% below year-ago levels (implying a third straight monthly increase in the index). The Bank of Canada pointed to the recovery in the housing market as an example of broader resilience in the economy, supporting its latest decision to hike rates 25 bps. If past tightening is any indication, sales activity should cool in the coming months as mortgage rates step up yet again.

United States

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Consumer Prices

Tuesday, 8:30 am

May (e)	**+0.2%**	**+4.1% y/y**
Consensus	*+0.2%*	*+4.1% y/y*
Apr.	+0.4%	+4.9% y/y

	Ex. Food & Energy	
May (e)	**+0.4%**	**+5.2% y/y**
Consensus	*+0.4%*	*+5.2% y/y*
Apr.	+0.4%	+5.5% y/y

May's **CPI** report is being released on the first day of the FOMC confab, with the potential to sway participants' opinions. We look for the total index to increase 0.2%, pulling headline inflation down by 0.8 ppts to 4.1% y/y. Lower gasoline prices and relatively flat food costs are expected to offset much of the influence of a 0.4% increase in the core index. Since peaking at 9.1% y/y last June, total inflation will have been sliced by more than half and is poised to slip into the 3%-range next period (assuming energy and food prices behave) because last June's figure was the strongest in more than 14 years at 1.2% m/m.

Meanwhile, the **core CPI** will likely register its fifth 0.4% reading in the past six months (the other one was 0.5%), pulling core inflation down by 0.3 ppts to 5.2% y/y and showing less impressive improvement from September's 6.6% peak. Weighing at about 40% of the core index, tenant and owners' equivalent rent rises should run around 0.5% m/m. Encouragingly, this will result in the first ebbing of annual rent inflation since early 2021, with April marking the peaks at 8.8% y/y for tenant rent and 8.1% for OER. The coming run of favourable year-ago comparisons (past monthly moves were repeatedly as high as 0.8%) and the lagged impact of falling market prices (which admittedly could now be starting to stabilize) should increasingly contribute meaningfully to core CPI disinflation.

Elsewhere, **core goods prices** should slip back under the radar after a surprise 0.6% rise in April, partly driven by a 4.4% spike in used vehicle costs. The leading Manheim measure spiked similarly in February, but it was +1.5% in March, -3.1% in April, and -2.7% in May. Higher costs for booze and meds could be persistent, however. Taken together, these point to a pickup in the CPI's **supercore proxy** from April's subdued 0.1% reading, but with the annual change still slipping from 5.1% y/y.

FOMC Announcement and Summary of Economic Projections

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

See Michael Gregory's Thought on page 2.

Retail Sales

Thursday, 8:30 am

		Ex. Autos
May (e)	**unch**	**+0.2%**
Consensus	*unch*	*+0.1%*
Apr.	+0.4%	+0.4%

	Ex. Autos/Gas
May (e)	**+0.3%**
Consensus	*+0.4%*
Apr.	+0.6%

Retail sales are expected to remain unchanged in May, suggesting consumer spending may be stalling. Compared to a year ago, sales are up just 1.6%—versus the 2% increase in core goods inflation—suggesting that retail sales volumes have fallen slightly in the past year. Auto sales fell, partly due to seasonal factors, while receipts at the pump declined amid a 3% drop in gas prices. Excluding autos and gas, sales look to edge up 0.3%. While this is a downshift from the prior month's 0.6% gain, a strong job market and excess savings have prevented the almighty consumer from faltering.

Industrial Production

Thursday, 9:15 am

	Industrial Production	Capacity Utilization
May (e)	**+0.2%**	**79.8%**
Consensus	*+0.1%*	*79.7%*
Apr.	+0.5%	79.7%

Industrial production remains firm and is expected to edge up 0.2% in May. Manufacturing—the biggest component—looks to climb 0.1%. The latest ISM survey showed production returned to expansion in the month. Meantime, mining is expected to gain for the second straight month, while choppy utilities could erase some of April's losses. Capacity utilization looks to edge up 0.1 ppts to 79.8%. Despite a slew of economic headwinds, industrial production continues to hold above year-ago levels.

Central Banks

ECB Monetary Policy Announcement

Thursday, 8:15 am ET
Press conference at 8:45 am ET

See Jennifer Lee's Thought on page 5.

BoJ Monetary Policy Announcement

Friday

Financial Markets Update for June 9, 2023

		Jun 9 [1]	Jun 2	Week Ago	4 Weeks Ago	Dec 31, 2022
					(basis point change)	
Canadian	Call Money	4.75	4.50	25	25	50
Money Market	Prime Rate	6.95	6.70	25	25	50
U.S. Money	Fed Funds (effective)	5.25	5.25	0	0	75
Market	Prime Rate	8.25	8.25	0	0	75
3-Month Rates	Canada	4.80	4.60	20	45	57
	United States	5.23	5.35	-12	8	89
	Japan	-0.18	-0.18	0	-1	0
	United Kingdom	4.83	4.89	-7	14	95
	Australia	4.21	4.08	13	32	94
2-Year Bonds	Canada	4.51	4.30	21	78	46
	United States	4.58	4.50	8	59	15
10-Year Bonds	Canada	3.40	3.23	17	52	10
	United States	3.75	3.70	6	29	-12
	Japan	0.42	0.41	1	4	1
	Germany	2.39	2.31	8	12	-18
	United Kingdom	4.24	4.15	9	47	58
	Australia	3.95	3.64	31	62	-10
Risk Indicators	VIX	13.6	14.6	-1.0 pts	-3.5 pts	-8.1 pts
	Inv. Grade CDS Spread [2]	71	72	0	-10	-11
	High Yield CDS Spread [2]	444	450	-5	-56	-40
					(percent change)	
Currencies	US¢/C$	75.06	74.49	0.8	1.7	1.7
	C$/US$	1.332	1.343	—	—	—
	¥/US$	139.43	139.92	-0.4	2.7	6.3
	US$/€	1.0758	1.0708	0.5	-0.8	0.5
	US$/£	1.258	1.245	1.0	1.0	4.1
	US¢/A$	67.42	66.10	2.0	1.4	-1.0
Commodities	CRB Futures Index	262.32	259.69	1.0	1.7	-5.6
	Oil (generic contract)	71.60	71.74	-0.2	2.2	-10.8
	Natural Gas (generic contract)	2.28	2.17	5.2	0.8	-49.0
	Gold (spot price)	1,963.74	1,947.97	0.8	-2.3	7.7
Equities	S&P/TSX Composite	19,972	20,025	-0.3	-2.2	3.0
	S&P 500	4,322	4,282	0.9	4.8	12.6
	Nasdaq	13,325	13,241	0.6	8.5	27.3
	Dow Jones Industrial	33,967	33,763	0.6	2.0	2.5
	Nikkei	32,265	31,524	2.4	9.8	23.6
	Frankfurt DAX	15,973	16,051	-0.5	0.4	14.7
	London FT100	7,571	7,607	-0.5	-2.4	1.6
	France CAC40	7,223	7,271	-0.6	-2.6	11.6
	S&P ASX 200	7,123	7,145	-0.3	-1.8	1.2

[1] = as of 10:50 am *[2] = One day delay*

	Monday June 12	Tuesday June 13	Wednesday June 14	Thursday June 15	Friday June 16
China	**Agg. Yuan Financing** / **New Yuan**[D] **May (e) 1.9 trln 1.6 trln** Apr. 1.2 trln 0.7 trln **M2 Money Supply**[D] **May (e) +12.0% y/y** Apr. +12.4% y/y			**Industrial Production** / **Retail Sales** **May (e) +3.5% y/y +13.7% y/y** Apr. +5.6% y/y +18.4% y/y **Fixed Asset Investment (YTD)** **May (e) +4.4% y/y** Apr. +4.7% y/y	
Japan	**Producer Prices** **May (e) -0.2% +5.6% y/y** Apr. +0.2% +5.8% y/y **Machine Tool Orders** **May P** Apr. -14.4% y/y			**Trade Deficit** **May '23 (e) ¥1.2 trln** May '22 ¥2.4 trln **Core Machine Orders** **Apr. (e) +3.2% -8.3% y/y** Mar. -3.9% -3.5% y/y **Bank of Japan Monetary Policy Meeting (June 15-16)**	
Europe		**GERMANY** **Consumer Prices** **May F (e) -0.2% +6.3% y/y** Apr. +0.6% +7.6% y/y **ZEW Survey—Expectations** **June (e) -13.5** May -10.7 **UNITED KINGDOM** **Payrolls** **May (e) +21k** Apr. -136k **Employment (3m/3m)** / **Jobless Rate** **Apr. (e) +158k 4.0%** Mar. +182k 3.9% **Avg Wkly Reg. Earnings (3m/3m)** **Apr. (e) +6.9% y/y** Mar. +6.7% y/y	**EURO AREA** **Industrial Production** **Apr. (e) +0.7% +0.9% y/y** Mar. -4.1% -1.4% y/y **UNITED KINGDOM** **Monthly Real GDP** / **3m/3m** **Apr. (e) +0.2% +0.1%** Mar. -0.3% +0.1% **Services Index** / **3m/3m** **Apr. (e) +0.3% -0.1%** Mar. -0.5% +0.1% **Industrial Production** **Apr. (e) -0.1% -1.8% y/y** Mar. +0.7% -2.0% y/y **Trade Deficit** **Apr. (e) £16.5 bln** Mar. £16.4 bln	**EURO AREA** **Trade Surplus** **Apr. (e) €5.0 bln** Mar. €17.0 bln **8:15 am ECB Monetary Policy Meeting (8:45 am Press Conference)** **FRANCE** **Consumer Prices** **May F (e) -0.1% +6.0% y/y** Apr. +0.7% +6.9% y/y	**EURO AREA** **Consumer Prices** **May F (e) unch +6.1% y/y** Apr. +0.6% +7.0% y/y **Core CPI** **May F (e) +5.3% y/y** Apr. +5.6% y/y **Labour Costs** **Q1** Q4 +5.7% y/y **ITALY** **Consumer Prices** **May F (e) +0.3% +8.1% y/y** Apr. +0.9% +8.7% y/y
Other	**AUSTRALIA** **Markets closed**	**AUSTRALIA** **CBA Household Spending** **May** Apr. -4.3% +3.7% y/y **Westpac Consumer Confidence** **June** May -7.9% **NAB Business Confidence** **May** Apr. 0		**AUSTRALIA** **Employment** / **Jobless Rate** **May (e) +15,000 3.7%** Apr. -4,300 3.7% **NEW ZEALAND** **Real GDP** **Q1 (e) -0.1% +2.6% y/y** Q4 -0.6% +2.2% y/y	

[D] = date approximate

Upcoming Policy Meetings | Bank of England: June 22, Aug. 3, Sep. 21 | European Central Bank: July 27, Sep 14, Oct. 26

North American Calendar — June 12–June 16

Canada

Monday June 12

Tuesday June 13

11:15 am	Cash management bond buybacks $0.5 bln	

Wednesday June 14

8:30 am	**National Balance Sheet and Financial Flow Accounts (Q1)**	
8:30 am	**New Motor Vehicle Sales[D]**	
Apr. (e)	**+1.5% y/y**	
Mar.	+2.7% y/y	

Thursday June 15

8:15 am	**Housing Starts**	
May (e)	**250,000 a.r. (-4.4%%)**	
Apr.	261,559 a.r. (+22.3%)	
8:30 am	**Construction Investment**	
Apr.		
Mar.	-1.3%	+0.1% y/y
8:30 am	**Mfg. Sales**	**Mfg. New Orders**
Apr. (e)	**-0.2%**	**-0.2%**
Mar.	+0.7%	-3.5%
9:00 am	**Exis. Home Sales**	**Avg. Prices**
May (e)	**+4.0% y/y**	**+1.5% y/y**
Apr.	-19.5% y/y	-3.9% y/y
9:00 am	**MLS Home Price Index**	
May (e)	**-9.0% y/y**	
Apr.	-12.3% y/y	
Noon	2-year bond auction $4.75 bln	
	10-year bond auction announcement	

Friday June 16

8:30 am	**Wholesale Trade**	
Apr. (e)	**+1.6%**	
Mar.	-0.1%	
8:30 am	**Int'l Securities Transactions**	
	Inflows	**Outflows**
Apr.		
Mar.	-$19.1 bln	-$5.6 bln

United States

Monday June 12

2:00 pm	**Budget Balance**	
May '23 (e)	**-$236.0 bln[c]**	
May '22	-$66.2 bln	
11:30 am	26-week bill auction $58 bln	
11:30 am	3-year note auction $40 bln	
1:00 pm	13-week bill auction $65 bln	
1:00 pm	10[R]-year note auction $32 bln	

Tuesday June 13

6:00 am	**NFIB Small Business Economic Trends Survey**	
May (e)	**88.4[c]**	
Apr.	89.0	
8:30 am	**Consumer Prices**	
May (e)	**+0.2%**	**+4.1% y/y**
Consensus	*+0.2%*	*+4.1% y/y*
Apr.	+0.4%	+4.9% y/y
8:30 am	**CPI ex. Food & Energy**	
May (e)	**+0.4%**	**+5.2% y/y**
Consensus	*+0.4%*	*+5.2% y/y*
Apr.	+0.4%	+5.5% y/y
	FOMC Meeting begins	
11:00 am	4-, 8- & 17-week bill auction announcements	
11:30 am	52-week bill auction $38 bln	
11:30 am	42-day cash management bill auction $45 bln	
1:00 pm	30[R]-year bond auction $18 bln	

Wednesday June 14

7:00 am	**MBA Mortgage Apps**	
June 9		
June 2	-1.4%	
8:30 am	**PPI Final Demand**	
May (e)	**-0.1%**	**+1.4% y/y**
Consensus	*-0.1%*	*+1.4% y/y*
Apr.	+0.2%	+2.3% y/y
8:30 am	**PPI Final Demand ex. F&E**	
May (e)	**+0.2%**	**+2.9% y/y**
Consensus	*+0.2%*	*+2.9% y/y*
Apr.	+0.2%	+3.2% y/y
2:00 pm	**FOMC Announcement and Summary of Economic Projections**	
2:30 pm	**Fed Chair Powell's Press Briefing**	
11:30 am	17-week bill auction	

Thursday June 15

8:30 am	**Initial Claims**	
June 10 (e)	**250k (-11k)[c]**	
June 3	261k (+28k)	
8:30 am	**Continuing Claims**	
June 3		
May 27	1,757k (-37k)	
8:30 am	**Retail Sales**	**Ex. Autos**
May (e)	**unch**	**+0.2%**
Consensus	*unch*	*+0.1%*
Apr.	+0.4%	+0.4%
8:30 am	**Retail Sales ex. Autos/Gas**	
May (e)	**+0.3%**	
Consensus	*+0.4%*	
Apr.	+0.6%	
8:30 am	**Import Prices**	
May (e)	**-0.6%**	**-5.9% y/y**
Consensus	*-0.6%*	*-5.8% y/y*
Apr.	+0.4%	-4.8% y/y
8:30 am	**Philadelphia Fed Index**	
June (e)	**-12.5[c]**	
May	-10.4	
8:30 am	**Empire State Mfg. Survey**	
June (e)	**-15.1[c]**	
May	-31.8	
9:15 am	**Indust. Prod.**	**Cap. Utilization**
May (e)	**+0.2%**	**79.8%**
Consensus	*+0.1%*	*79.7%*
Apr.	+0.5%	79.7%
10:00 am	**Business Inventories**	
Apr. F (e)	**+0.2%[c]**	
Apr. P	+0.2%	
Mar.	-0.2%	
4:00 pm	**Net TIC Flows**	
	Total	**Long Term**
Apr.		
Mar.	$56.7 bln	$133.3 bln
11:30 am	4- & 8-week bill auctions	
11:00 am	20[R]-year bond, 5[R]-year TIPS auction announcements	

Friday June 16

10:00 am	**University of Michigan Consumer Sentiment**	
June P (e)	**60.0[c]**	
May	59.2	

Fed Speakers: St. Louis' Bullard (3:00 am); Governor Waller (7:45 am)

[c] = consensus [D] = date approximate [R] = reopening **Upcoming Policy Meetings** | Bank of Canada: July 12, Sep. 6, Oct. 25 | FOMC: July 25-26, Sep. 19-20, Oct. 21-Nov. 1

General Disclosures

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