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Economic Development Winnipeg

WEEKLY ECONOMIC DIGEST

INFLATION FACTORS AND CANADA'S EXPECTED MONETARY POLICY ACTIONS

EFFECTS ON MANITOBA HOUSEHOLDS AND ORGANIZATIONS

Chris Ferris, Senior Economist

Bottom Line

Supply shocks from outside of Canada are driving much of our current inflation. Russia's invasion of Ukraine is driving up **commodity prices** (food, fuel, fertilizer, and various metals) and shipping of these bulk commodities. **Containerized shipping** of goods from China/East Asia to West Coast North America continues to be extremely backlogged, particularly ports around Shanghai and along the Yangtze River. This is due to restrictions requiring zero COVID-19 cases. Air travel and air freight out of Shanghai has likewise been disrupted.

In Canada, the largest subcomponent of the Consumer Price Index (CPI) is shelter. Shelter inflation for Canada and Manitoba has been rising slightly faster than overall CPI inflation. **Higher interest rates will help cool residential real estate price growth. At the same time, governments and the private sector are taking actions to increase housing supply – particularly in large urban markets.**

(continued).

Bottom Line (Continued)
The Bank of Canada's (BoC) April 2022 forecast of CPI inflation had a peak of approximately six per cent in Q2 2022. The BoC's April 2022 forecast of annual CPI inflation showed an average of 5.3 per cent in 2022, falling to 2.8 per cent in 2023 and 2.1 per cent in 2024. The June 1, 2022, announcement may see higher inflation in 2022 and 2023.

CPI Inflation	2021	2022	2023	2024
April 2022	3.4	5.3	2.8	2.1
Previous	3.4	4.2	2.3	-
Change	0	+1.1	+0.5	-

On May 26, 2022, the C.D. Howe Monetary Policy Council (MPC) unanimously called for a 50-basis point increase to 1.50 per cent on June first. They are calling for an interest rate of 2.50 per cent by the December announcement date and staying at that level through June 2023. This would be an increase of 1.50 percentage points from the current one per cent overnight rate. Most of the MPC members are calling for quantitative tightening (QT) to be accelerated from its current pace.

Households and organizations need to consider a variety of interest-rate increase scenarios. [1] This will help them to understand what debt levels remain affordable, and what projects may still have positive returns on investment (ROI). Have related conversations with your advisors (e.g., banker, accountant) **sooner rather than later so you have time to adjust before interest rates bite.** This applies to Manitobans and all other Canadians.

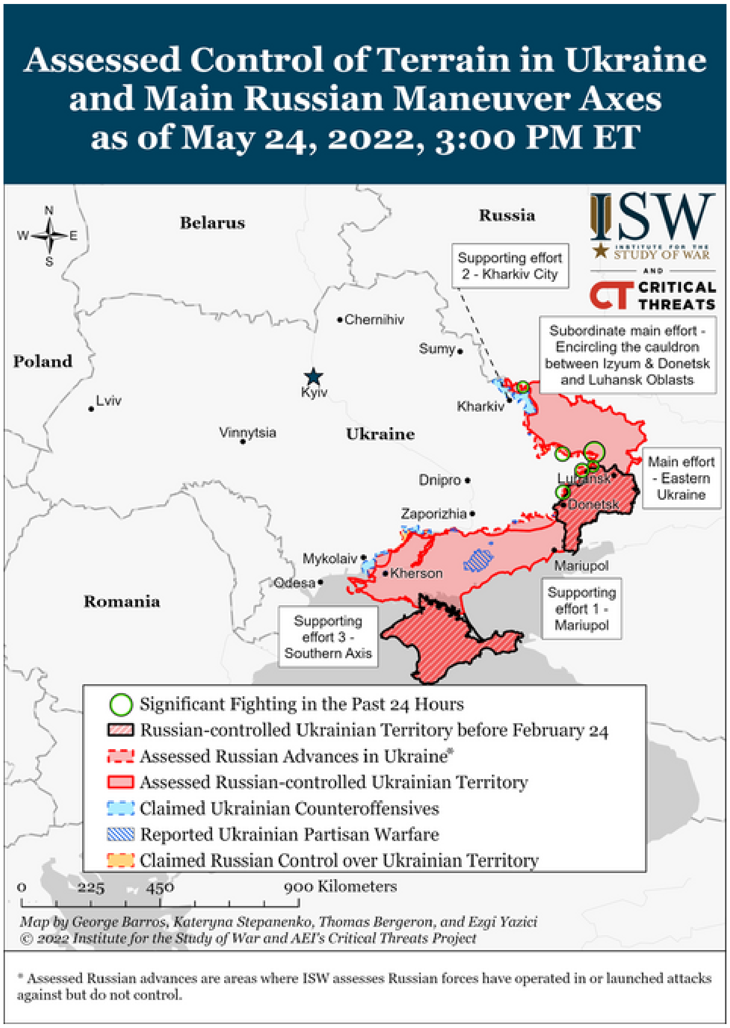
ANALYSIS

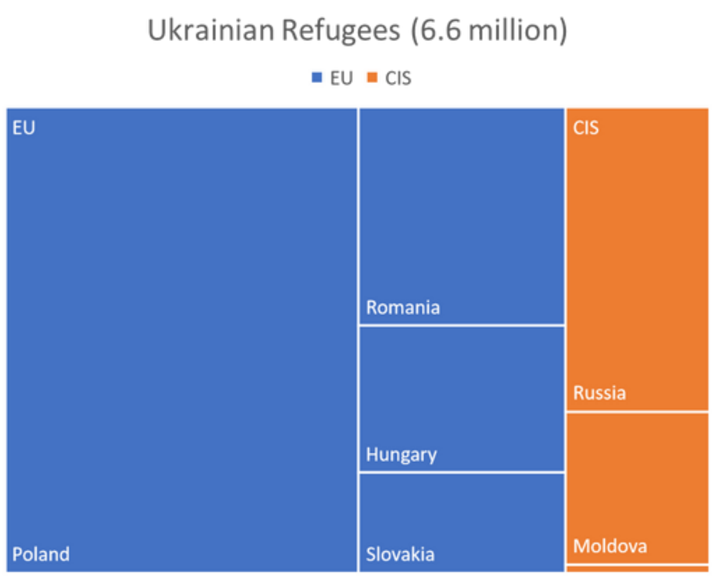
Pandemic disruptions to economies around the globe have resulted in significant inflation pressures. Layered on top of this are the disruptions of the Russian invasion of Ukraine and the current supply chain chaos in China due to lockdowns in Shanghai and other coastal cities.

Global Factors
The COVID-19 pandemic caused significant disruption to economic activity around the world, including global value chains. Lockdowns, shifts from services to goods, changes in the delivery of goods and services (e.g., ecommerce) and adjustments to demand forecasts across thousands of inputs and products have all played a role. Restocking of product inventories last fall saw significant backlogs of goods from Asia into the West Coast of North America, as we had documented in **WED vol. 2, Issue 38**. Thus, the **Bullwhip effect** has played a significant role in many different commodity, intermediate and final good markets, which has been worsened by lockdowns and other factors.**[2]**

[1] E.g., increases of 1.0, 1.5, 2.0 and higher percentage points from their current level.
[2] Lee, Padmanabhan and Whang (April 15, 1997). "The Bullwhip Effect in Supply Chains," MIT Sloan Management Review, https://sloanreview.mit.edu/article/the-bullwhip-effect-in-supply-chains/.

ANALYSIS





Russian Invasion of Ukraine (Began February 24, 2022)

As we documented in **[WED Vol. 3, Issue 4](#)**, there have been significant disruptions to world wheat and other crops, fertilizers, oil and natural gas as well as numerous minerals due to this invasion (and sanctions on Russia). This has driving up global inflation, and disrupted bulk commodity supply chains.

Ukraine, with supplies and weapons from the West, has managed to repel Russian forces from Northern Ukraine. Currently actions are taking place in the East and South of Ukraine. **[3]**

At the same time, approximately 6.6 million Ukrainians have fled/gone into nearby countries since the beginning of the invasion. **[4]**

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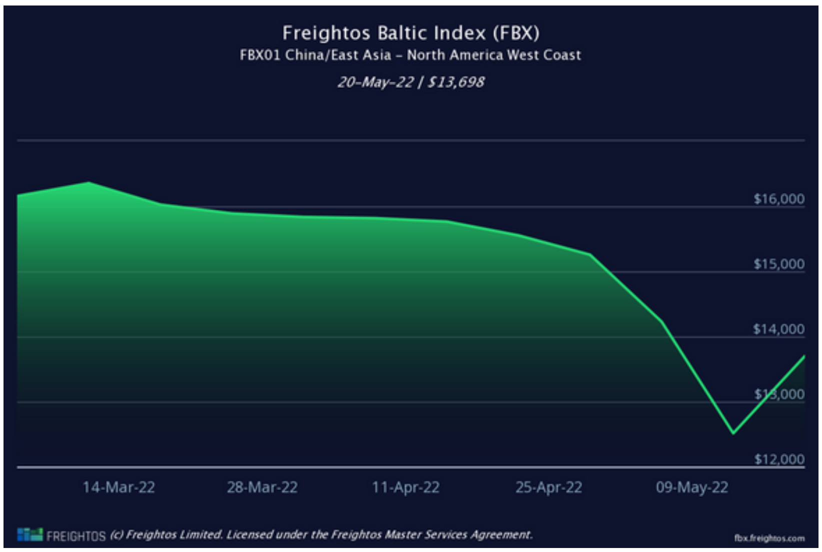
[3] Source for map, Institute for the Study of War. May 24, 2022. **Russian Offensive Campaign Assessment, May 24 | Institute for the Study of War (understandingwar.org)**.
[4] Ukrainian Refugees as of May 24, 2022. **Ukraine Refuge Situation (unhcr.org)**. CIS = Commonwealth of Independent States.

ANALYSIS

China Supply Chain Chaos: COVID Zero Policy

Container ships anchoring off the coast of Shanghai and other Chinese ports have become significantly backed up due to the lockdowns in those cities.**[5]** Shanghai's ports are open but have supply chain chaos due to: factory shutdowns, container truck shortages causing container dwell times to rise to 12 days vs. four days in March and numerous air flights cancelled, including freight flights.



A Laura He (May 6, 2022) CNN article notes that "*Nearly 20% of container vessels globally are currently waiting outside congested ports, …. Almost a quarter of those unberthed ships are stuck outside Chinese ports. That is 412 ships, up 58% since February, the survey added.*"

A recent article in Inside Logistics says that Shanghai is due to fully reopen June 1, 2022.**[6]** Even if this is borne out and sustained, it will take quite some time to clear up backlogged orders and restore fluidity to the system.

The ratio in container freight costs from China/East Asia to West Coast North America ($13,698/day) and the reverse trip ($832/day) is 16.5 to one, a significant difference.**[7]**

[5] Source: May 10, 2022 **MarineTraffic: Global Ship Tracking Intelligence | AIS Marine Traffic** Cargo Vessels and Tankers that are at anchor – Ports of Shanghai and up the Yangtze River to around Nanjing. See also: Laura He (May 6, 2022), "**Shipping delays are back as China's lockdowns ripple around the world, CNN. Shipping delays are back as China's lockdowns ripple around the world | CNN Business**. As of 2021, there are estimated to be 5,434 container ships in the world, according to Statista. • Global number of containers ships 2021 | Statista.

[6] Shanghai port handles about 20 per cent of China's shipping volumes, which is why is so important for global supply chains. May 26, 2022. **https://www.insidelogistics.ca/opinions/shanghai-worlds-biggest-port-is-returning-to-normal-but-supply-chains-will-get-worse-before-they-get-better/**.

[7] Source: Freightos (May 20, 2022) FBX01, China/East Asia to North America West Coast. Daily rates for container vessels. $13,698 per day on May 20th; down 16 per cent from March 11th's $16,353 per day. **FBX China/East Asia - North America West Coast - Freight Rate Index (freightos.com)**. The reverse trip was $832 per day on May 20th; down 18 per cent from March 11th's $1,020 per day.

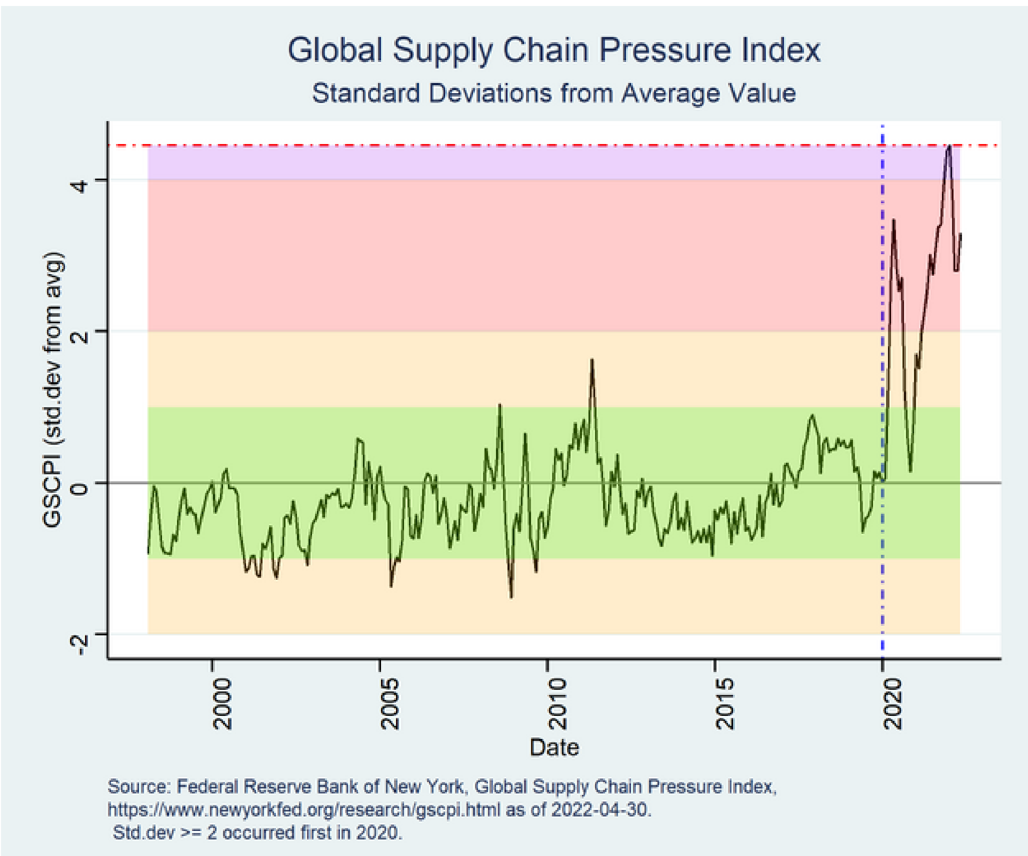
ANALYSIS

COVID Zero and serious issues in the Chinese real estate markets are putting a significant drag on Chinese GDP growth. Fiscal and monetary stimulus is being prepared in China to offset some of these issues. Vaccinating older citizens and then changing their COVID policy (*considering faster spreading COVID variants make the policy much less effective than back in 2020*) would be beneficial for the Chinese economy.

A New Global Supply Chain Pressure Index from the NY Fed

In the interest of blending together various elements of the supply chain, the New York Fed has released a new monthly Global Supply Chain Pressure Index (**GSCPI**).**[8]** This index shows the **standard deviation (SD)** from the average value.**[9]** The GSCPI starts on Jan 1998, with monthly measures through April 30, 2022.

The first time the GSCPI exceeded two SD was in 2020, driven by the COVID-19 pandemic, and reactions to it. The index hit a high of 4.45 SD on Dec 2021, and is still elevated at 3.29 SD. We are not out of the woods until we see the index drop below two SD and stay there for some time.



[8] The GSCPI blends information on the **Baltic Dry Index**, **Harpex index**, **air freight costs indexes** from the **BLS** of the USA, and supply chain related components from **Purchasing Managers' Index** surveys for manufacturers in China, the euro area, Japan, South Korea, Taiwan, the UK, and the USA.

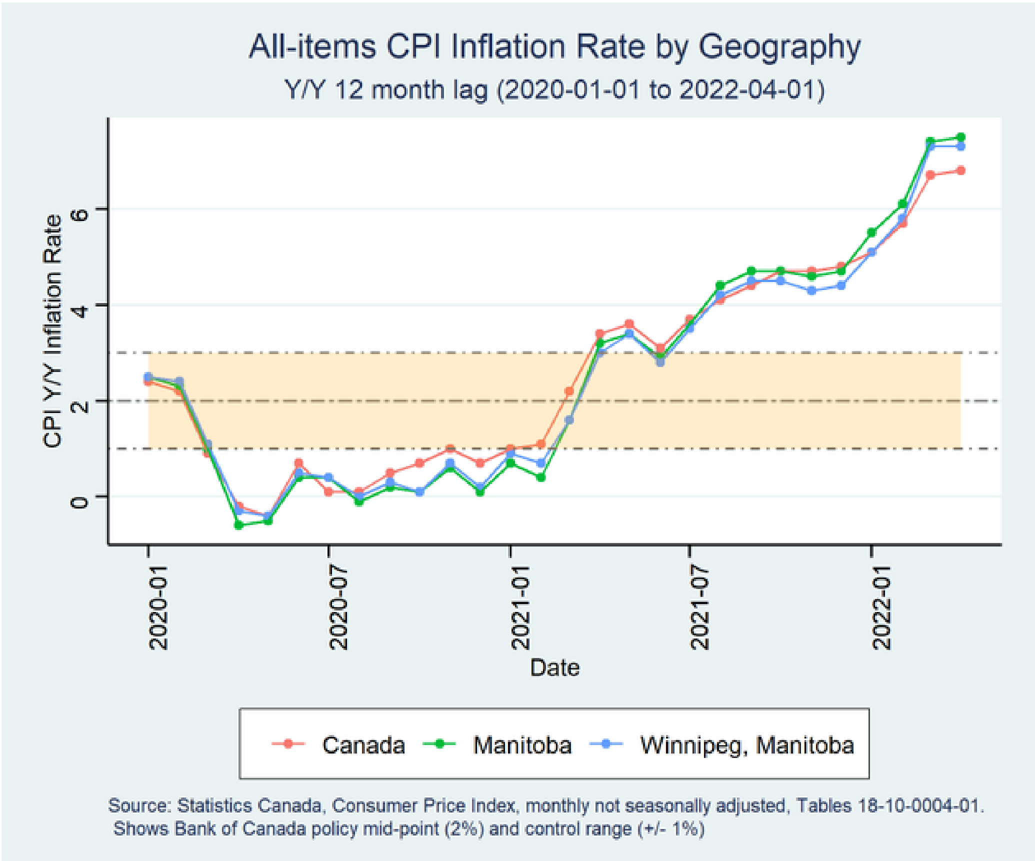
[9] Under a normal distribution, approximately 68 per cent of the results falls within +/- 1 SD of the mean, 95 per cent of the results fall within +/- 2 SD of the mean, and 99 per cent falls within +/- 3 SD of the mean. Thus, the current result can be considered unusual. See **https://sphweb.bumc.bu.edu/otlt/MPH-Modules/PH717-QuantCore/PH717-Module6-RandomError/PH717-Module6-RandomError5.html**.

ANALYSIS

Geography	Y/Y CPI Inflation (per cent)	
	March 2022	April 2022
Canada	6.7%	6.8%
Manitoba	7.4%	7.5%
Winnipeg CMA	7.3%	7.2%

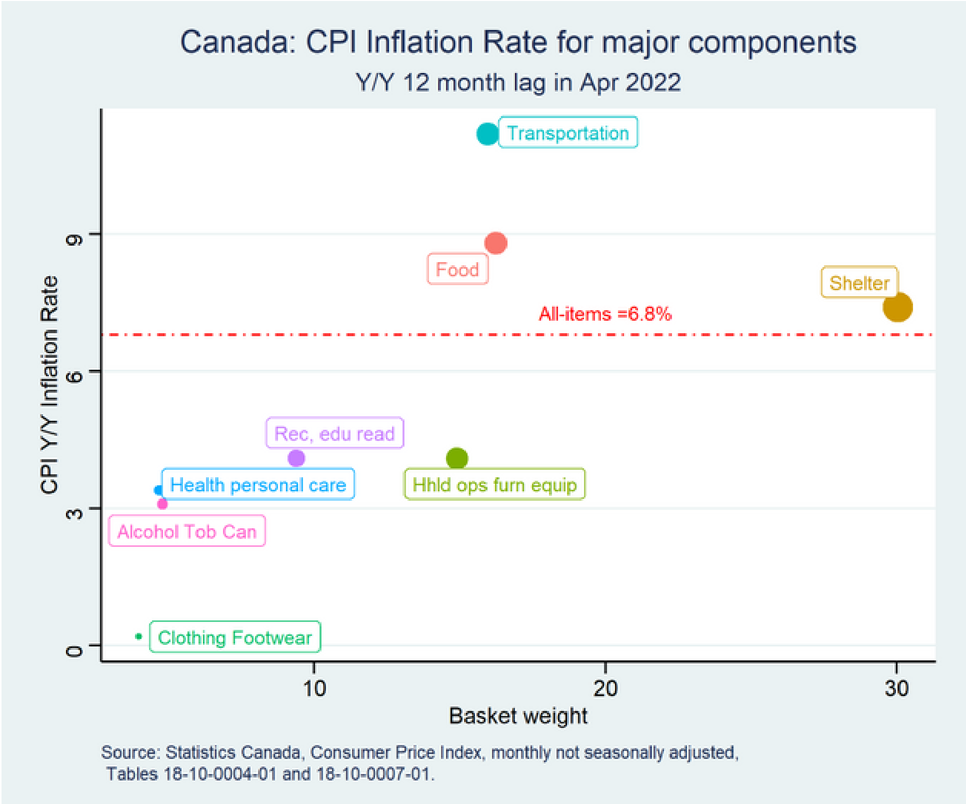
Inflation: Canada, Manitoba, and Winnipeg CMA

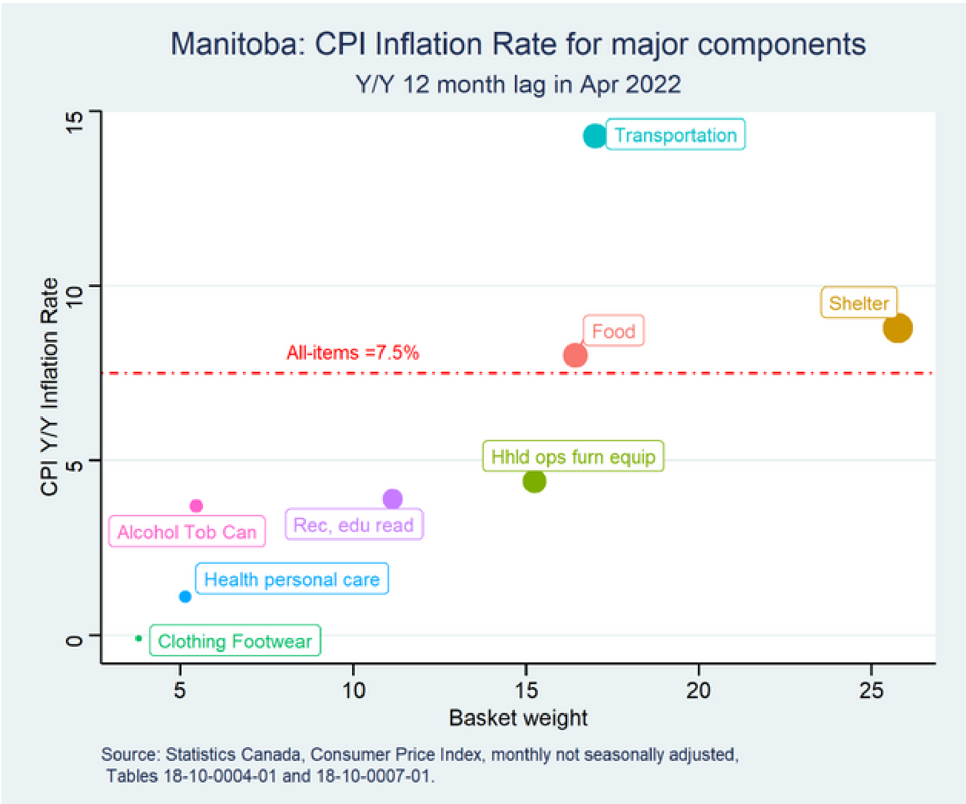
Statistics Canada released the April 2022 Consumer Price Index on May 18, 2022. April 2022 inflation remained high but moved sideways versus March 2022 inflation.



ANALYSIS

CPI inflation is being driven higher by transportation, food and shelter for Canada and Manitoba.





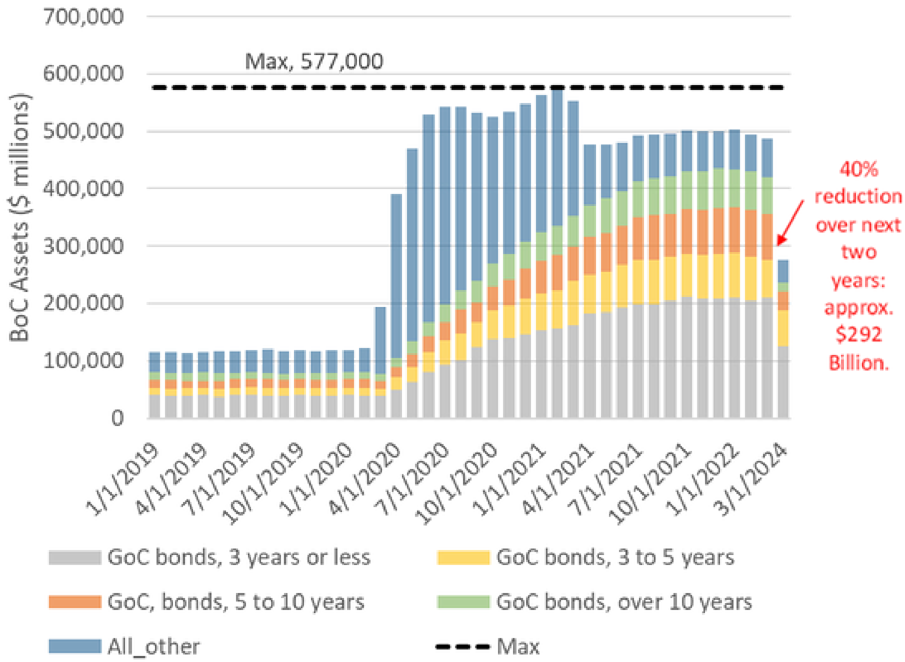
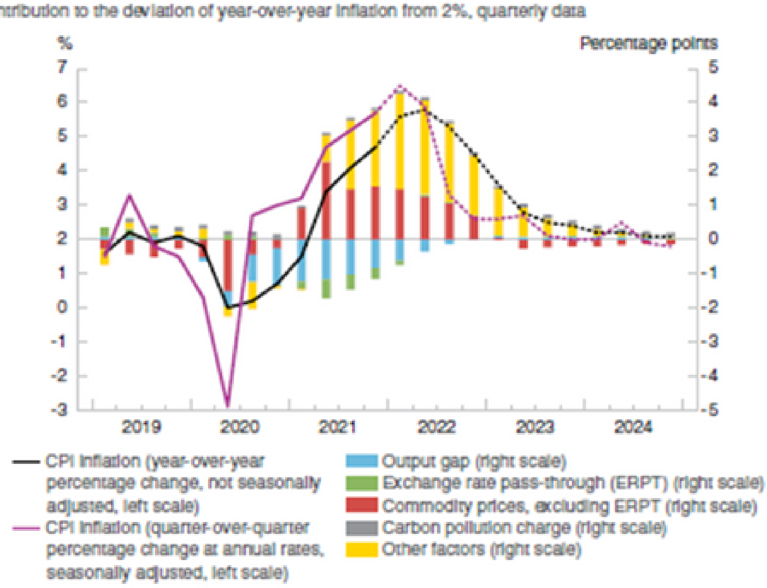


Chart 17: CPI inflation to ease as the effects of supply disruptions and high energy prices fade and monetary stimulus is reduced

Contribution to the deviation of year-over-year inflation from 2%, quarterly data



Note: "Other factors" includes, in particular, the impacts of various supply-related disruptions on inflation, such as the effects of semiconductor shortages on motor vehicle prices, of shipping bottlenecks on goods prices, and of unfavourable weather conditions on food prices. Numbers may not add to total due to rounding.

Sources: Statistics Canada and Bank of Canada calculations, estimates and projections

Looking Forward to the Bank of Canada's June 1, 2022, interest rate announcement

The Bank of Canada (BoC) expects to roll off about 40 per cent of bonds over the next two years. Their total assets were $487 billion at the end of March 2022, so this would result in the balance sheet shrinking to approximately $292 billion. **[10]** Other major central banks are in a comparable situation.

Most of the C.D. Howe's MPC members are calling for quantitative tightening (QT) to be accelerated from its announced pace. If this were to happen, then we could see the BoC's balance sheet fall to between $150 and $292 billion by March 2024.

Surging commodity prices and supply chain issues are expected to continue driving inflation throughout 2022 and into 2023, as shown by **Chart 17** from the Monetary Policy Review in April 2022.

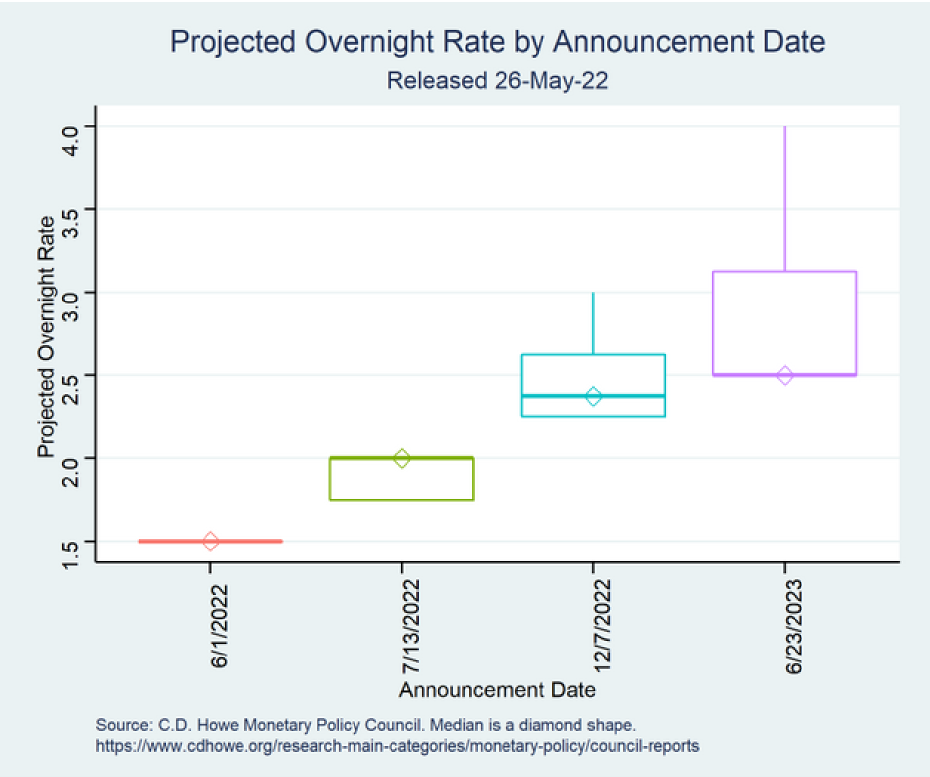
[10] Source: Statistics Canada: Table 10-10-0108-01.

Chart 2: The oil and gas sector has been a drag on investment growth

Contribution of investment in oil and gas to total investment growth, annual data

Sources: Statistics Canada and Bank of Canada calculations

Last observation: 2020



The Perfect Storm

Remarks by Toni Gravelle, Deputy Governor of the Bank of Canada (May 12, 2022) to the Association des économistes Québécois called "**The Perfect Storm**," noted several pertinent items. While commodity prices have been surging, we are not seeing strong investment in oil and gas sector (**see Chart 2**). Therefore, Canada's exchange rate has begun to decouple from the Bank's commodity prices index. The strong crude prices have been beneficial for oil and gas companies and has made a positive contribution to federal and provincial government coffers.

On May 26, 2022, the C.D. Howe Monetary Policy Council (MPC) unanimously called for a 50-basis point increase to 1.50 per cent on June first.**[11]**

[11] Source: C.D. Howe Monetary Policy Council May 26, 2022 Communique **C.D. Howe Institute Monetary Policy Council Calls for Bank of Canada to Raise Overnight Rate to 1.50 Percent Next Week and 2.00 Percent in July, and Sell Bonds | C.D. Howe Institute | Canada Economy News | Canadian Government Policy (cdhowe.org)**.

The C.D. Howe MPC is calling for:

- a further 50-basis points increase on July 13 to 2.00 per cent.
- an interest rate of 2.50 per cent by the December announcement date and staying at that level through June 2023. **This would be an increase of 1.50 percentage points from the current one per cent overnight rate.**

Increasing the overnight interest rate attacks the aggregate supply shock indirectly by decreasing aggregate demand, thus bringing aggregate supply and demand back into balance.

INQUIRIES AND CONTACTS

If you require help accessing government programs, contact our YES! Winnipeg team through the **Help us help you form**.
General inquires: **wpginfo@edwinnipeg.com**
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