WEEKLY COMMENTARY

Business Investment: The Other Urgent Matter

By Jimmy Jean, Vice-President, Chief Economist and Strategist

Canada's economy is at an inflection point, and its lack of productive business investment is a major cause for concern. Since 2019, real non-residential investment per capita has grown 11.5% in the United States but shrunk 8.6% in Canada (graph). The problem is serious and should probably top governments' ever-growing list of priorities.

That's because the trend is well entrenched. Canadian business investment intentions are at their lowest level since the pandemic began, and they've now fallen for seven straight quarters. In a note next week, we'll look at how the ratio of the capital stock to the working-age population may have recorded its biggest decline in half a century in 2023.

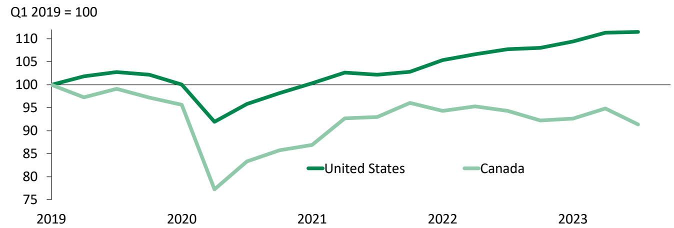
There are a number of reasons for this. One is the drop in fossil-fuel extraction investment. In 2014, the sector accounted for nearly 30% of non-residential investment. By 2022, that figure had fallen to 11%. But oil and gas generates the most wealth per worker of any sector. The good news is that utilities, which include renewable electricity, come in second. The bad news is that until investment in renewable energy really takes off, the pullback in fossil fuel investment leaves a productivity gap. And while renewable energy may be clean, it's no substitute for oil when it comes to wealth generation. Oil and gas exports totalled nearly $175 billion in 2022, while electricity exports came in at just $5.8 billion. Critical minerals have significantly better export potential, but they won't make much of an impact in the near term. According to the International Energy Agency, it takes on average nearly 17 years to develop a mine.

In addition to shifts in the footprint of Canada's highly productive sectors, regulatory red tape and uncertainty may be another reason behind the country's weak productive investment. The long list of regulation mismatches across provinces, which are holding back inter-provincial trade, comes to mind. In 2019, the Bank of Canada estimated that Canada's economic potential

Graph

The United States Outpaces Canada on Per Capita Non-residential Investment

Per capita non-residential investment



Statistics Canada and Desjardins Economic Studies

would be 0.2 percentage points higher if obstacles like these were eliminated. But the issue has taken a back seat to other government priorities since the pandemic.

Meanwhile Canada's corporate tax system is less advantageous than it was before the Trump administration cut the US corporate tax rate. Today's high borrowing costs aren't making things any easier for businesses either. And while businesses cite difficulty finding the skilled labour they need to be innovative, a lack of competition in many Canadian industries also means there isn't much incentive to innovate.

Lethargic investment has many concerning implications. Barring a turnaround, Canada's economic potential will probably continue to grow slowly. That means a lower standard of living for Canadians, which we've already seen with the 2.3% year-over-year decline in real GDP per capita in the third quarter of 2023. A lack of investment is also likely to generate persistent inflationary pressures requiring higher interest rates to prevent an imbalance in aggregate supply and demand. It would also translate to commercial R&D delays, slowing down innovation. This would all result in lost market share, compromising

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Canada's ability to compete on the global stage and make the technological discoveries that are needed to accelerate the climate transition. Another serious consequence? Inadequate wealth generation could jeopardize the sustainability of public finances at all levels of government. This would be especially true for the provinces, whose spending budgets are already swelling to meet the needs of a quickly growing and aging population.

Given this gloomy picture, Canada must take aggressive action to spur business investment. This includes changing regulatory and tax policy, providing additional support for innovation and making a concerted effort to boost human capital—especially by quickly integrating immigrants with valuable job skills. This poses a triple challenge for policymakers, who will have to solve the puzzle of private investment, accelerate the energy transition and keep public finances on a sustainable path. There's just no way around it.

What to Watch For

By Randall Bartlett, Senior Director of Canadian Economics, Tiago Figueiredo, Associate – Macro Strategy,
Marc Desormeaux, Principal Economist, Marc-Antoine Dumont, Economist, and Francis Généreux, Principal Economist

UNITED STATES

WEDNESDAY January 17 - 8:30

December	m/m
Consensus	0.4%
Desjardins	0.3%
November	**0.3%**

Retail sales (December) – Retail sales delivered a big upside surprise in November. Several indicators had suggested a much smaller advance than the robust 0.3% gain (0.6% excluding motor vehicles and gasoline) that was posted. We expect total sales to have grown by a similar amount in December. First, data released in early January showed an uptick in new car sales in the last month of 2023. Second, seasonal adjustments will likely show that gasoline station sales held steady, rather than dropping sharply as they did in previous months. Preliminary data from card transactions also suggests that sales in other retail categories didn't change much. Building materials stores and apparel seem to have done well, but electronics and grocery store sales probably dropped. We therefore expect a 0.3% pickup in total retail sales and a slight 0.1% increase in sales excluding motor vehicles and gasoline.

WEDNESDAY January 17 - 9:15

December	m/m
Consensus	0.3%
Desjardins	-0.3%
November	**0.2%**

Industrial production (December) – After October's 0.9% decline, which was largely due to the autoworkers' strike, industrial production gained 0.2% in November. We expect production to have cooled again in December. The biggest drag probably came from the energy sector, as demand for heating appears to have been weak that month, since the whole country experienced warmer-than-usual average temperatures, including record highs in the North and Midwest. Changes in hours worked in other categories, including manufacturing, proved relatively flat in December. Total industrial production likely dipped 0.3%.

THURSDAY January 18 - 8:30

December	ann. rate
Consensus	1,425,000
Desjardins	1,400,000
November	**1,560,000**

Housing starts (December) – Housing starts climbed 14.8% in November, bringing them to their highest since May. The situation seems too good to last, so we expect a pullback in December. But warm weather may have tempered the decline. Meanwhile, the addition of 3,900 residential construction jobs could have been another positive factor. We nevertheless expect housing starts to have fallen to 1.4 million. Even though that's less than the surprising November figure, it's still higher than the readings for the preceding months.

FRIDAY January 19 - 10:00

January	Index
Consensus	69.3
Desjardins	70.0
December	**69.7**

University of Michigan consumer sentiment index (January – preliminary) – The University of Michigan consumer sentiment index jumped 9.7 points in December. This was its biggest monthly gain since March 2021, when most US households received a big payout from the federal government. Among other things, lower gasoline prices helped lift consumer sentiment by bringing down inflation expectations. This factor won't have as much of an impact in January. Gasoline prices have fallen further, but so far the decline has been less impressive. The stock market's strength also helped boost confidence in December, but gains since the New Year have been much more modest and less broad-based. Consequently, we expect confidence in January to stay essentially unchanged from December.

FRIDAY January 19 - 10:00

December	ann. rate
Consensus	3,830,000
Desjardins	3,820,000
November	**3,820,000**

Existing home sales (December) – In November, existing home sales went up month-on-month for the first time since May. After the 0.8% advance in November, we expect existing home sales to have levelled off in December. Pending home sales flatlined the month before. Preliminary regional data is telling the same story.

CANADA

MONDAY January 15 - 8:30

November	m/m
Consensus	0.6%
Desjardins	1.2%
October	**-2.8%**

Manufacturing sales (November) – Manufacturing sales in Canada are expected to have advanced by 1.2% m/m in November, in line with Statistics Canada's flash estimate, following a 2.8% drop in the prior month. This advance was likely roughly evenly divided between prices and volumes, with the seasonally adjusted Industrial Products Price Index rising by 0.7% in the month.

MONDAY January 15 - 9:00

December	m/m
Consensus	n/a
Desjardins	0.5%
November	**-0.9%**

Existing home sales (December) – Preliminary data from local real estate boards suggests a pickup in homebuying activity in several large Canadian cities. As such, we're forecasting that national-level purchases recorded a 0.5% uptick in December—the first increase since June. The most striking early result came in Toronto, whose board reported a nearly 12% year-over-year jump following meaningful declines in the prior four months. Despite that, and signs of strength in Vancouver and Alberta, it'll still be too soon to say whether prospective buyers are already responding to lower bond yields. But for signs of where prices could go in the coming months, we'll also be watching new listings. Following a six-month surge, the number of homes for sale across Canada has now fallen back in two consecutive months. Another decline would imply prospective sellers are choosing to wait until more buyers come off the sidelines. An increase would suggest that some mortgage holders are struggling to cover sharply higher debt servicing costs.

TUESDAY January 16 - 8:15

December	ann. rate
Consensus	n/a
Desjardins	212,000
November	**212,600**

Housing starts (December) – Despite surprising resilience and some month-over-month volatility, Canadian housing starts were likely unchanged in December from the prior month. We're also sticking to our call that homebuilding will trend lower in 2024. We've said it before and we'll say it again: rates, building costs, homebuilder sentiment and labour shortages all point to much weaker construction activity going forward. Moreover, in Toronto and Vancouver, projects financed before borrowing costs surged and the macroeconomic backdrop soured have anchored activity in recent months. Given that these two cities were responsible for much of last year's surprising resilience in housing starts, more muted homebuilding is likely going forward.

TUESDAY January 16 - 8:30

December	m/m
Consensus	-0.3%
Desjardins	-0.3%
November	**0.1%**

Consumer Price Index (December) – In December, headline consumer price growth likely rose to 3.4% on an annual basis, the fastest pace since September 2023. That said, much of the expected increase was due to base effects, as energy prices moved lower in the final month of 2023. Excluding food and energy prices, core inflation probably remained at roughly 3.5% year-over-year. Outside of that traditional core inflation measure, the Bank of Canada will look for further progress on its median and trimmed-mean indicators. The annual rates of these measures likely fell a tick to 3.3% and 3.4% respectively in December. Their 3-month annualized rates had already fallen back into the Bank of Canada's 1 to 3 percent target range recently and are likely to have remained there in December. As a result, the Bank of Canada's measures of inflation should suggest that the central bank is making further progress towards taming excess inflationary pressures.

FRIDAY January 19 - 8:30

November	m/m
Consensus	0.0%
Desjardins	0.0%
October	**0.7%**

Retail sales (November) – Retail sales were likely flat in November, after increasing slightly in the previous two months. As a result, our forecast for November is in line with Statistics Canada's flash estimate. We expect monthly auto sales to show solid growth driven by higher volumes, and gasoline sales likely increased on a seasonally adjusted basis. Still, weakness in other retail sectors probably pushed core sales growth into negative territory. For December's flash estimate, we expect a very slight decrease, as momentum in auto sales looks to have faded in the month.

OVERSEAS

MONDAY January 15 - 4:00

2023	y/y
Consensus	-0.3%
2022	**1.8%**

Germany: Annual real GDP (2023 – preliminary) – 2023 was a tough year for the German economy. After shedding 0.4% at the very end of 2022 (resulting in negative carryover), German real GDP held steady in the first quarter of 2023. It then edged up 0.1% in Q2 only to slide 0.1% over Q3. If real GDP growth stayed flat in the fourth quarter, the annual figure should show a modest contraction for 2023 as a whole. But real GDP may have lost more ground in Q4, since industrial production and retail sales struggled for several months.

TUESDAY January 16 - 21:00

Q4 2023	y/y
Consensus	5.2%
Q3 2023	**4.9%**

China: Real GDP (fourth quarter) – After China posted real GDP growth of 1.3% in the third quarter, the consensus expects data for the end of 2023 to reveal a slowdown of about 1.0%. This would bring growth for 2023 as a whole to 5.2%. While monthly indicators like retail sales and seasonally adjusted industrial production dipped slightly in October and November, PMI indexes also contracted, suggesting conditions wouldn't improve in December. The government nevertheless announced new stimulus measures aimed primarily at the property market and investment, which could fuel more growth over the short term. That said, these measures proved somewhat disappointing as they don't really address the structural issues facing the country's economy.

WEDNESDAY January 17 - 2:00

December	y/y
Consensus	3.8%
November	**3.9%**

United Kingdom: Consumer Price Index (December) – UK inflation slipped below 4% for the first time since September 2021. It remained high in November, coming in at 3.9% with core inflation settling even higher at 5.1%. But the situation is clearly improving, and it'll be interesting to see whether prices kept moving in the right direction in December.

THURSDAY January 18 - 18:30

December	y/y
Consensus	2.6%
November	**2.8%**

Japan: Consumer Price Index (December) – After peaking at 4.4% in January 2023, Japanese inflation eased slightly for the rest of the year. In November, it hit 2.8%, the first time it fell below 3% since September 2022. But core inflation proved stickier, coming in at 3.8% in November. Preliminary Tokyo data suggests that headline inflation may have slid once more, but core inflation might have remained unchanged.

Economic Indicators

Week of January 15 to 19, 2024

Day	Time	Indicator	Period	Consensus	Desjardins forecast	Previous reading
UNITED STATES						
MONDAY 15	---	Markets closed (Martin Luther King, Jr. Day)				
TUESDAY 16	8:30	Empire State Manufacturing Index	Jan.	-4.0	-9.0	-14.5
WEDNESDAY 17	8:30	Export prices (m/m)	Dec.	-0.7%	-0.6%	-0.9%
	8:30	Import prices (m/m)	Dec.	-0.6%	-0.3%	-0.4%
	8:30	Retail sales				
		Total (m/m)	Dec.	0.4%	0.3%	0.3%
		Excluding automobiles (m/m)	Dec.	0.2%	0.1%	0.2%
	9:15	Industrial production (m/m)	Dec.	0.0%	-0.3%	0.2%
	9:15	Production capacity utilization rate	Dec.	78.7%	78.5%	78.8%
	10:00	NAHB housing market index	Jan.	39	n/a	37
	10:00	Business inventories (m/m)	Nov.	-0.1%	-0.1%	-0.1%
	14:00	Release of the Beige Book				
THURSDAY 18	8:30	Initial unemployment claims	Jan. 8–12	205,000	207,000	202,000
	8:30	Philadelphia Fed index	Jan.	-7.0	-9.0	-12.8
	8:30	Housing starts (ann. rate)	Dec.	1,425,000	1,400,000	1,560,000
	8:30	Building permits (ann. rate)	Dec.	1,480,000	1,430,000	1,467,000
FRIDAY 19	10:00	University of Michigan consumer sentiment index – preliminary	Jan.	69.3	70.0	69.7
	10:00	Existing home sales (ann. rate)	Dec.	3,830,000	3,820,000	3,820,000
	16:00	Net foreign securities purchases (US$B)	Nov.	n/a	n/a	3.3
CANADA						
MONDAY 15	8:30	Wholesale sales (m/m)	Nov.	n/a	0.8%	-0.5%
	8:30	Manufacturing sales (m/m)	Nov.	0.6%	1.2%	-2.8%
	9:00	Existing home sales (m/m)	Dec.	n/a	0.5%	-0.9%
	10:30	Release of the Bank of Canada's Business Outlook Survey				
TUESDAY 16	8:15	Housing starts (ann. rate)	Dec.	n/a	212,000	212,600
	8:30	Consumer price index				
		Total (m/m)	Dec.	-0.3%	-0.3%	0.1%
		Total (y/y)	Dec.	3.2%	3.4%	3.1%
WEDNESDAY 17	8:30	International securities transactions ($B)	Nov.	n/a	n/a	-15.75
	8:30	Industrial product price index (m/m)	Dec.	n/a	-0.9%	-0.4%
	8:30	Raw materials price index (m/m)	Dec.	n/a	-1.6%	-4.2%
THURSDAY 18	---	---				
FRIDAY 19	8:30	Retail sales				
		Total (m/m)	Nov.	0.0%	0.0%	0.7%
		Excluding automobiles (m/m)	Nov.	n/a	-1.0%	0.6%

NOTE: Each week, Desjardins Economic Studies takes part in the Bloomberg survey for Canada and the United States. Approximately 15 economists are consulted for the Canadian survey and a hundred or so for the United States. The abbreviations m/m, q/q and y/y correspond to month-over-month, quarter-over-quarter and year-over-year change respectively. Following the quarter, the abbreviations f, s and t correspond to first estimate, second estimate and third estimate respectively. Times shown are Eastern Standard Time (GMT - 5 hours). Desjardins Economic Studies forecast.

Economic Indicators

Week of January 15 to 19, 2024

Country	Time	Indicator	Period	Consensus m/m (q/q)	Consensus y/y	Previous reading m/m (q/q)	Previous reading y/y
OVERSEAS							
MONDAY 15							
Germany	4:00	Annual GDP	2023		-0.3%		1.8%
Italy	4:00	Trade balance (€M)	Nov.	n/a		4,699	
Eurozone	5:00	Industrial production	Nov.	-0.3%	-6.0%	-0.7%	-6.6%
Eurozone	5:00	Trade balance (€B)	Nov.	n/a		10.9	
Japan	18:50	Producer price index	Dec.	0.0%	-0.3%	0.2%	0.3%
TUESDAY 16							
Germany	2:00	Consumer price index – final	Dec.	0.1%	3.7%	0.1%	3.7%
Germany	5:00	ZEW Current Conditions Survey	Jan.	-77.0		-77.1	
Germany	5:00	ZEW Expectations Survey	Jan.	12.0		12.8	
China	21:00	Real GDP	Q4	1.0%	5.2%	1.3%	4.9%
China	21:00	Industrial production	Dec.		6.8%		6.6%
China	21:00	Retail sales	Dec.		8.0%		10.1%
WEDNESDAY 17							
United Kingdom	2:00	Consumer price index	Dec.	0.2%	3.8%	-0.2%	3.9%
United Kingdom	2:00	Producer price index	Dec.	-0.2%	0.4%	-0.1%	-0.2%
Eurozone	5:00	Consumer price index – final	Dec.	0.2%	2.9%	0.2%	2.4%
Japan	23:30	Industrial production – final	Nov.	n/a	n/a	-0.9%	-1.4%
THURSDAY 18							
Eurozone	4:00	Current account (€B)	Nov.	n/a		33.8	
Italy	4:30	Current account (€M)	Nov.	n/a		3,315	
Eurozone	5:00	Construction	Nov.	n/a	n/a	-0.9%	-0.7%
Japan	18:30	Consumer price index	Dec.		2.6%		2.8%
Japan	23:30	Tertiary Industry Activity Index	Nov.	0.2%		-0.8%	
FRIDAY 19							
Germany	2:00	Producer price index	Dec.	-0.4%	-8.0%	-0.5%	-7.9%
United Kingdom	2:00	Retail sales	Dec.	-0.5%	1.1%	1.3%	0.1%

Note: Unlike release times for US and Canadian economic data, release times for overseas economic data are approximate. Publication dates are provided for information only. The abbreviations m/m, q/q and y/y correspond to month-over-month, quarter-over-quarter and year-over-year change respectively. Times shown are Eastern Standard Time (GMT - 5 hours).