

WEEKLY COMMENTARY



No Pain, No Gain for the Canadian Economy

By Randall Bartlett, Senior Director of Canadian Economics

August was a breath of fresh air after what has been a rough ride for the Canadian housing market. Average home prices posted their first monthly advance since February, and the pace of decline in sales slowed sharply. Housing starts also remained elevated. This comes after home prices took a turn for the worse after peaking nationally in February. Sales have fallen even further, quickly returning local housing markets to balanced territory, many of which had been buyer's markets throughout the pandemic or even before.

So where does Canadian housing go from here? That's largely up to the Bank of Canada, which shows no sign of relenting on rate hikes anytime soon. After a massive 100 bps increase in July and another 75 bps in September, the subsequent [speech by Senior Deputy Governor Carolyn Rogers](#) made clear that "...demand continues to outstrip supply in many parts of the Canadian economy, and short-term inflation expectations remain high. As long as this continues to be the case, there will be upward pressure on prices." And as long as there's upward pressure on prices, monetary policy can be expected to remain hawkish. We're anticipating another 50 bps hike in October, and maybe more by year's end.

Consequently, we don't expect last month's brief reprieve in the housing market correction to have staying power. While the path of home price declines may not be linear, the risk remains very much tilted to the downside as borrowing costs continue to ratchet up. But this is really only the beginning, as the brunt of higher interest rates is largely being borne by Canadians with variable-rate mortgages. Many fixed-rate mortgage holders haven't yet begun to feel the squeeze. Housing starts are also expected to follow existing home sales and prices lower, as falling demand hits new home construction with a lag.

Rising interest rates should continue to slow residential investment in Canada over the next couple of years. In fact, the pullback began in the second quarter of this year, with an annualized decline of nearly 28%. But that's not the only sector of the Canadian economy feeling the pain of higher borrowing costs. Real durable goods consumption dropped at an annual pace of 12% in the second quarter—the sharpest quarterly decrease since the depths of the pandemic lockdowns in Q2 2020. Other parts of the Canadian economy are holding up better so far, but monetary policy tightening will hamper their growth as well. As a result, we anticipate economic activity to moderate considerably in Canada, leading to a mild recession in the first half of 2023. (See our recent [Economic Viewpoint](#) on the topic.)

But there is a silver lining to all this. Slowing domestic demand will gradually reduce inflationary pressures, prompting the Bank of Canada to eventually cut interest rates. We're of the view that rate cuts will begin around the end of next year. This should help improve housing affordability, which has continued to erode on higher borrowing costs despite falling home prices. It doesn't mean there won't be some pain along with way. But as they say, "No pain, no gain."

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What to Watch For

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

TUESDAY September 20 - 8:30

August

Consensus	1,459,000
Desjardins	1,440,000
July	1,446,000

WEDNESDAY September 21 - 8:30

August

Consensus	4,700,000
Desjardins	4,780,000
July	4,810,000

WEDNESDAY September 21 - 14:00

September

Consensus	3.25%
Desjardins	3.25%
July 27	2.50%

THURSDAY September 22 - 10:00

August

Consensus	0.0%
Desjardins	-0.1%
July	-0.4%

MONDAY September 19 - 8:30

August

Consensus	nd
Desjardins	-0.4%
July	-2.1%

MONDAY September 19 - 8:30

August

Consensus	n/a
Desjardins	-2.3%
July	-7.4%

UNITED STATES

Housing starts (August) – Housing starts plunged 9.6% in July, down a total of 19.9% from their February peak. Although not quite as drastic, we're expecting another drop in new builds in August. Housing sales and building permits are still on the decline, pointing to a continued softening in housing starts. One sign of stability, however, is the 2,300 new residential construction jobs that were added. We expect housing starts to come in at 1,440,000 units in August.

Existing home sales (August) – Existing home sales fell for the sixth consecutive month in July, posting a total decline of 25.9% since January. Year-over-year sales dropped to 4,810,000 units, the lowest level since November 2015 excluding the first few months of the pandemic. Based on pending home sales, we expect a further decline in August. It's clear the uptick in mortgage rates, after an early summer lull, are a real thorn in the side of the housing market. Mortgage applications for home purchases are still down, and regional data is showing the resale market contracting in August as well. We think sales of existing homes will drop to 4,780,000 units.

Federal Reserve meeting (September) – The Federal Reserve will almost certainly go ahead with another substantial rate hike. Inflation is still high, particularly if you exclude the recent dip in gasoline prices, and job creation remains robust enough to support strong wage growth. That means the Fed still has work to do. Expectations are for another 75 basis point hike, but 100 isn't off the table. The Fed will also publish its latest projections on economic growth, inflation and a path for the federal funds rate over the next few years. We'll be looking to see whether these projections signal steeper rate hikes and if, under the circumstances, the Fed thinks we're headed for stormier economic weather.

Leading indicator (August) – The leading indicator is on a definite downward trend. It has now fallen 4 months in a row—something it hasn't done since 2019—for a total decline of 2.3%. While not yet time to panic, it's still an ominous sign for the economic outlook. We expect a further contraction in August. This time, consumer confidence and hours worked are the major headwinds. That said, we expect a less severe contraction than in July, tempered by stock market growth and falling unemployment claims. We forecast a 0.1% decline.

CANADA

Industrial Product Price Index (August) – Watch for a hat trick of monthly declines in the industrial product price index through August, with an expected 0.4% retreat in the month following two consecutive monthly drops. Ongoing pullbacks in commodity prices will likely be largely to blame. At the same time, a modest appreciation in the Canadian dollar in August probably softened the blow somewhat.

Raw Materials Price Index (August) – Following a precipitous drop in the raw materials price index in July, August's anticipated 2.3% decline should be modest by comparison. Commodity prices fell at a slower pace than they did the month before. A slight uptick in the Canadian dollar in August also likely helped take the edge off the monthly retreat.

TUESDAY September 20 - 8:30

August	m/m
Consensus	-0.1%
Desjardins	-0.1%
July	0.1%

Consumer Price Index (August) – Canadian consumers saw cheaper gas prices in August. But the discounts from falling fuel prices might have just offset higher prices in other areas. Food prices rose more than usual for this time of year. Moreover, while lower house prices may have eased affordability concerns in the shelter component, rising rent and mortgage interest costs for homeowners likely outweighed that decrease. Overall, even with a sharp drop in gasoline prices, expect the headline consumer price index to have declined just 0.1%. That would leave the annual rate of inflation tracking 7.3%, which is still miles above the Bank of Canada's 2% target. Core measures of inflation are also likely to have remained hot in August, tracking above 5% on average. The persistence of these strong inflationary pressures will keep the Bank of Canada on course for another oversized interest rate increase in October.

FRIDAY September 23 - 8:30

July	m/m
Consensus	-2.0%
Desjardins	-1.9%
June	1.1%

Retail sales (July) – Retail sales are expected to have contracted 1.9% m/m in July, slightly less precipitous than Statistics Canada's -2.0% advance estimate. This would follow six straight monthly increases. Such a decline will likely reflect a retreat in both retail sales volumes and prices in the month. On the volumes side, lower employment, consumer goods imports, wholesale trade and seasonally-adjusted auto sales probably suppressed activity. At the same time, seasonally-adjusted goods CPI fell for the first time since 2020 on a monthly basis in July, as falling prices at the pump drove the index lower. Excluding sales of motor vehicles, retail sales are expected to come in closer to -0.9% in the month.

OVERSEAS
THURSDAY September 22 - 7:00

September	
Consensus	2.25%
Desjardins	2.25%
August 4	1.75%

United Kingdom: Bank of England meeting (September) – After its most recent meeting in August, the Bank of England (BoE) announced a 50-basis-point rate hike in an attempt to tame stronger and more persistent inflation. A repeat 50-point hike seems a likely outcome of its September meeting, although 75 points wouldn't be completely unexpected in light of recent decisions by other major central banks. It appears the game plan in many countries is to act fast and ramp up monetary tightening to prevent inflation from becoming entrenched. In the BoE's defence, it had a much earlier start to its rate hikes.

THURSDAY September 22 - 10:00

September	
Consensus	-25.4
August	-24.9

Eurozone: Consumer confidence (September – preliminary) – European consumer confidence is in the basement, with rising energy prices and economic anxiety clearly having an effect on the population. Confidence levels are consistent with a drop in real spending. It remains to be seen if this downtrend will continue in September.


FRIDAY September 23 - 4:00


September	
Consensus	49.0
August	48.9

Eurozone: Purchasing Managers' Index (September – preliminary) – Consumer sentiment has clearly taken a hit, but business sentiment less so. We've seen PMI data fall in recent months, even dropping below the 50 mark in some cases, but it doesn't necessarily spell disaster. For the time being, the data points to more of a lull in economic growth than an actual recession. September data will tell us where things go from here.

Economic Indicators

Week of September 19 to 23, 2022

Date	Time	Indicator	Period	Consensus		Previous data
UNITED STATES						
MONDAY 19						
	10:00	NAHB housing market index	Sept.	48	n/a	49
TUESDAY 20						
	8:30	Housing starts (ann. rate)	Aug.	1,459,000	1,440,000	1,446,000
	8:30	Building permits (ann. rate)	Aug.	1,610,000	1,650,000	1,685,000
WEDNESDAY 21						
	10:00	Existing home sales (ann. rate)	Aug.	4,700,000	4,780,000	4,810,000
	14:00	Federal Reserve meeting	Sept.	3.25%	3.25%	2.50%
	14:30	Speech of the Federal Reserve Chair, J. Powell				
THURSDAY 22						
	8:30	Initial unemployment claims	Sept. 12-16	220,000	217,000	213,000
	8:30	Current account (US\$B)	Q2	-258.4	-263.0	-291.4
	10:00	Leading indicator (m/m)	Aug.	0.0%	-0.1%	-0.4%
FRIDAY 23						
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CANADA						
MONDAY 19						
	8:30	Industrial product price index (m/m)	Aug.	n/a	-0.4%	-2.1%
	8:30	Raw materials price index (m/m)	Aug.	n/a	-2.3%	-7.4%
TUESDAY 20						
	8:30	Consumer price index				
		Total (m/m)	Aug.	-0.1%	-0.1%	0.1%
		Total (y/y)	Aug.	7.2%	7.3%	7.6%
	15:45	Speech of a Bank of Canada Deputy Governor, P. Beaudry				
WEDNESDAY 21						
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THURSDAY 22						
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FRIDAY 23						
	8:30	Retail sales				
		Total (m/m)	July	-2.0%	-1.9%	1.1%
		Excluding automobiles (m/m)	July	-1.1%	-0.9%	0.8%

Note: Desjardins, Economic Studies are involved every week 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 monthly, quarterly and yearly variation respectively. Following the quarter, the abbreviations f, s and t correspond to first estimate, second estimate and third estimate respectively. The times shown are Eastern Standard Time (GMT - 4 hours).  Forecast of Desjardins, Economic Studies of the Desjardins Group.

Economic Indicators

Week of September 19 to 23, 2022

Country	Time	Indicator	Period	Consensus		Previous data	
				m/m (q/q)	y/y	m/m (q/q)	y/y
OVERSEAS							
MONDAY 19							
Euro zone	5:00	Construction	July	n/a	n/a	-1.3%	0.1%
Japan	19:30	Consumer price index	Aug.		2.9%		2.6%
TUESDAY 20							
Germany	2:00	Producer price index	Aug.	1.7%	36.6%	5.3%	37.2%
Sweden	3:30	Bank of Sweden meeting	Sept.	1.50%		0.75%	
Euro zone	4:00	Current account (€B)	July	n/a		4.2	
Italy	4:30	Current account (€M)	July	n/a		-1,112	
WEDNESDAY 21							
Japan	---	Bank of Japan meeting	Sept.	n/a		-0.10%	
Brazil	17:30	Bank of Brazil meeting	Sept.	13.75%		13.75%	
THURSDAY 22							
France	2:45	Business confidence	Sept.	102		103	
France	2:45	Production outlook	Sept.	-5		-2	
Switzerland	3:30	Swiss National Bank meeting	Sept.	0.50%		-0.25%	
Norway	4:00	Bank of Norway meeting	Sept.	2.25%		1.75%	
United Kingdom	7:00	Bank of England meeting	Sept.	2.25%		1.75%	
Euro zone	10:00	Consumer confidence – preliminary	Sept.	-25.4		-24.9	
United Kingdom	19:01	Consumer confidence	Sept.	-42		-44	
FRIDAY 23							
France	2:45	Wages – final	Q2	n/a		1.0%	
France	3:15	PMI composite index – preliminary	Sept.	49.9		50.4	
France	3:15	PMI manufacturing index – preliminary	Sept.	49.9		50.6	
France	3:15	PMI services index – preliminary	Sept.	50.5		51.2	
Germany	3:30	PMI composite index – preliminary	Sept.	46.2		46.9	
Germany	3:30	PMI manufacturing index – preliminary	Sept.	48.3		49.1	
Germany	3:30	PMI services index – preliminary	Sept.	47.2		47.7	
Euro zone	4:00	PMI composite index – preliminary	Sept.	48.2		48.9	
Euro zone	4:00	PMI manufacturing index – preliminary	Sept.	48.8		49.6	
Euro zone	4:00	PMI services index – preliminary	Sept.	49.2		49.8	
United Kingdom	4:30	PMI composite index – preliminary	Sept.	49.0		49.6	
United Kingdom	4:30	PMI manufacturing index – preliminary	Sept.	47.5		47.3	
United Kingdom	4:30	PMI services index – preliminary	Sept.	50.1		50.9	

Note: In contrast to the situation in Canada and the United States, disclosure of overseas economic figures is much more approximate. The day of publication is therefore shown for information purposes only. The abbreviations m/m, q/q and y/y correspond to monthly, quarterly and yearly variation respectively. The times shown are Eastern Standard Time (GMT - 4 hours).