

WEEKLY COMMENTARY

Decisions, Decisions

By Royce Mendes, Managing Director and Head of Macro Strategy

On the surface, it might seem like the Bank of Canada has an easy decision to make next week. Inflation isn't hot enough nor is the economy strong enough to warrant further rate increases. But, by the same token, inflation isn't low enough nor is the economy weak enough to warrant a rate cut. As a result, you don't need a PhD in economics to determine that the target for the policy rate should remain on hold at 5.00% on January 24. However, central bankers have more than that one decision to consider.

Inflation has fallen from a peak of over 8% to just over 3%. Much of what's left driving above-target inflation is attributable to shelter, which in turn is being driven by high interest rates. Excluding shelter, inflation is now running at 2.4%, down from 6.0% in December 2022. On the other hand, the Bank of Canada's core median and trim measures suggest that underlying price pressures remain between 3.5% and 4.0%. In determining whether to emphasize the progress on inflation excluding shelter or the stickiness in the core median and trim measures, Governing Council will effectively be communicating whether or not the door is open to rate cuts in upcoming months.

Analysts will, therefore, be parsing the words in the statement and the materials in the Monetary Policy Report. We expect that the Bank of Canada will lean more dovish given some of the concerning responses seen in their surveys of businesses and households. Both reported a soft outlook for the economy and lower inflation expectations, while firms also stated that pricing behaviour was normalizing.

The Bank of Canada takes these surveys and their informal discussions with Canadian households and businesses very seriously. This comes as Statistics Canada data has shown stagnant economic growth and rising unemployment in recent quarters. So, while the core measures of inflation showed less progress than we were anticipating, we are still calling for a rate

cut in April. Waiting too long to begin reducing rates would leave tens of thousands of Canadian homeowners renewing mortgages at interest rates higher than necessary to bring inflation to heel—the one mandate of the Bank of Canada.

The other decision that needs to be made regards the central bank's quantitative tightening (QT) program. The Bank of Canada has been allowing the bonds it purchased during its quantitative easing (QE) program to mature and roll off its balance sheet. But, since October, there have been some signs that policymakers might need to tap the brakes on QT.

The market interest rate that the Bank of Canada uses most often to implement its monetary policy has drifted far enough above its target that the central bank has had to inject overnight liquidity of between \$5B and \$10B in 10 of the first 14 trading days of the year.

Tapering or ending QT isn't an easy decision to take. It would mean that the Bank of Canada's purchases of Government of Canada bonds were not temporary after all, opening the institution up to criticism that it had financed the federal government's massive COVID deficits.

Avoiding political crossfire is critical to the central bank, but maintaining financial stability is sacrosanct. If the markets department at 234 Wellington Street in Ottawa determines that restraining QT is necessary, they won't hesitate to act. With only roughly \$10B of the \$270B in bond assets held on the balance sheet maturing from now until the end of March, there's time for policymakers to wait and see. But the central bank will have to answer, either in their prepared materials or their responses to journalists' questions, what policymakers plan to do should these financial system frictions persist.

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Desjardins Economic Studies: 514-281-2336 or 1-866-866-7000, ext. 5552336 • desjardins.economics@desjardins.com • desjardins.com/economics

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We have always expected the Bank of Canada would need to wind down QT before the balance sheet reached its theoretical target size. Each time the US Federal Reserve conducted QE stateside, the central bank was never able to fully reverse its purchases. In simple terms, banks and regulators get used to having this liquidity in the system, making it difficult to drain. We expect the Bank of Canada to, therefore, end QT this year and potentially taper the balance sheet wind down in the first half of the year.

Signalling rate cuts or an end to QT too early, however, risks seeing financial conditions ease aggressively, which in turn could leave inflation lingering above target for longer than central bankers are comfortable with. So, while policymakers have some easy decisions to make on the policy rate and QT next week, their communications will set the tone for markets, which have already opened the year in choppy fashion.

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

MONDAY January 22 - 10:00

December	m/m
Consensus	-0.3%
Desjardins	-0.2%
November	-0.5%

THURSDAY January 25 - 8:30

Q4 1st est.	ann. rate
Consensus	2.0%
Desjardins	2.0%
Q3 3rd est.	4.9%

THURSDAY January 25 - 8:30

December	m/m
Consensus	1.0%
Desjardins	0.8%
November	5.4%

THURSDAY January 25 - 10:00

December	ann. rate
Consensus	650,000
Desjardins	660,000
November	590,000

UNITED STATES

Leading indicator (December) – The leading indicator continues to trend lower. There hasn't been a month-over-month increase since March 2022. In fact, the indicator has posted 20 consecutive month-over-month declines, which is almost as bad as the 22-month downtrend recorded during the 2008–2009 crisis. We expect another pullback in December. Once again, interest rate spreads, consumer confidence and the ISM index were likely the main culprits behind the indicator's descent. These negative factors were probably partially offset by a strong stock market and lower jobless claims. The leading indicator is expected to have shed 0.2%, which would be its smallest monthly contraction since August 2022.

Real GDP (fourth quarter – 1st estimate) – After robust annualized growth of 4.9% in the third quarter, we expect GDP to have lost some momentum in the last quarter of 2023. That said, the slowdown was likely mild. Real consumption has remained surprisingly strong and is expected to have increased nearly 2.5% on an annualized basis. Business investment, especially in equipment and intellectual property, probably even accelerated slightly. However, residential investment, net exports and government spending are expected to have provided less support than they did in the previous quarter. Private inventory investment was lower than in Q3, which likely took a big bite out of GDP growth. We expect real GDP to have increased an annualized 2.0%. This would bring annual growth for 2023 to 2.5%, up from 1.9% for 2022.

Durable goods orders (December) – A resurgence of nondefense aircraft orders gave durable goods orders a substantial boost in November. This propelled the monthly gain to 5.4%, the highest it's been since Q3 2020. We believe the increase was more modest in December. Although aviation orders may have remained strong, they probably lost considerable momentum compared to November. We also expect the auto industry to have provided some lift. Transportation likely grew by more than 2%, but that's much less than the 15.3% posted in November. Excluding transportation, we expect a slight 0.1% drop, in line with the ISM manufacturing index and recent changes in industrial production. All things considered, durable goods orders probably rose 0.8%.

New home sales (December) – New home sales plunged to a 12-month low in November. Just 590,000 homes were sold that month, down from 672,000 in October. This represents a 12.2% drop, the worst since April 2022. There's no doubt that higher mortgage rates, which didn't start coming down until fall, fuelled this correction. But the lower rates observed over the last few months of 2023 have buoyed the market. Builder confidence has improved, and mortgage applications for home purchases rebounded in December. Furthermore, building permits for single-family homes grew 1.7% in the final month of the year. We therefore expect single-family home sales to have grown to 660,000 units.

WEDNESDAY January 24 - 9:45
January

Consensus	5.00%
Desjardins	5.00%

December 6 5.00%
CANADA

Bank of Canada interest rate announcement (January) – The Bank of Canada is expected to keep rates unchanged next week for the fourth consecutive meeting. Canadian central bankers will be waiting for the effects of past rate hikes to continue to work their way through the economy. The key point of focus will be how the Bank characterizes the recent increase in inflation. Ultimately, we expect that the Bank of Canada will lean more dovish given some of the concerning responses seen in their surveys of businesses and households. Aside from rates, the other decision that needs to be made regards the central bank’s quantitative tightening (QT) program. The recent injections of liquidity have raised some eyebrows and brought forward the discussion around tapering or even ending QT. While we don’t expect a decision to be made, central bankers will have to answer questions around the future of the program.

TUESDAY January 23
January

Consensus	-0.10%
Desjardins	-0.10%

December 19 -0.10%
OVERSEAS

Japan: Bank of Japan meeting (January) – The Bank of Japan (BoJ) continued to go its own way in December, maintaining an expansionary monetary policy with a sub-zero rate. The BoJ hasn’t ruled out the possibility of eventually raising its policy rate, but it doesn’t seem particularly eager to do so. It will most likely decide to keep its key rate unchanged in January. Its main goal is to keep inflation close to 2% over the medium term. Inflation is currently above that target, but the BoJ remains concerned that it will fall too far below it over the medium term, especially if salaries don’t rise fast enough. Japan has a long history of weak inflation that sometimes turns into deflation.

WEDNESDAY January 24 - 4:00
January

Consensus	48.0
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December 47.6

Eurozone: Purchasing Managers’ Index (January – preliminary) – After edging up in November, the eurozone composite PMI came in at 47.6 for the second month in a row in December. Still, both the service and manufacturing components posted gains last month. Although this suggests that the worst is past, Europe’s economic challenges are far from over. Interest rate hikes have taken a toll on manufacturing, which had already been struggling for several years. In addition, the PMIs for certain countries, such as Germany, have a long way to go before they cross the 50-point threshold that would mark the beginning of an expansion. Their current levels suggest the eurozone’s real GDP stayed flat or even fell as the year began.

THURSDAY January 25 - 8:15
January


Consensus	4.50%
Desjardins	4.50%


December 14 4.50%

Eurozone: European Central Bank meeting (January) – We agree with the consensus view that the European Central Bank (ECB) will keep its rates unchanged. But it will be interesting to look at the press release announcing its monetary policy decision and Christine Lagarde’s comments at the ECB press conference to see what kind of tone they strike. It would be surprising if the ECB opens the door to interest rate cuts right away. Since inflation didn’t budge in December, caution is still warranted. If markets price in several key rate cuts too soon, the economy may get an unwelcome boost that could help keep inflation too high for longer.

Economic Indicators

Week of January 22 to 26, 2024

Day	Time	Indicator	Period	Consensus		Previous reading
UNITED STATES						
MONDAY 22	10:00	Leading indicator (m/m)	Dec.	-0.3%	-0.2%	-0.5%
TUESDAY 23	---	---				
WEDNESDAY 24	---	---				
THURSDAY 25	8:30	Initial unemployment claims	Jan. 15–19	200,000	205,000	187,000
	8:30	Real GDP (ann. rate)	Q4f	2.0%	2.0%	4.9%
	8:30	Durable goods orders (m/m)	Dec.	1.0%	0.8%	5.4%
	8:30	Goods trade balance – preliminary (US\$B)	Dec.	-88.5	-93.1	-89.3
	8:30	Retail inventories (m/m)	Dec.	n/a	n/a	-0.1%
	8:30	Wholesale inventories – preliminary (m/m)	Dec.	-0.2%	n/a	-0.2%
	10:00	New home sales (ann. rate)	Dec.	650,000	660,000	590,000
FRIDAY 26	8:30	Personal income (m/m)	Dec.	0.3%	0.3%	0.4%
	8:30	Personal consumption expenditures (m/m)	Dec.	0.4%	0.5%	0.2%
	8:30	Personal consumption expenditures deflator				
		Total (m/m)	Dec.	0.2%	0.2%	-0.1%
		Excluding food and energy (m/m)	Dec.	0.2%	0.2%	0.1%
		Total (y/y)	Dec.	2.6%	2.7%	2.6%
		Excluding food and energy (y/y)	Dec.	3.0%	3.0%	3.2%
	10:00	Pending home sales (m/m)	Dec.	1.5%	n/a	0.0%
CANADA						
MONDAY 22	---	---				
TUESDAY 23	---	---				
WEDNESDAY 24	9:45	Bank of Canada meeting	Jan.	5.00%	5.00%	5.00%
THURSDAY 25	---	---				
FRIDAY 26	---	---				

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 22 to 26, 2024

Country	Time	Indicator	Period	Consensus		Previous reading	
				m/m (q/q)	y/y	m/m (q/q)	y/y
OVERSEAS							
MONDAY 22							

TUESDAY 23							
Japan	---	Bank of Japan meeting	Jan.	-0.10%		-0.10%	
Eurozone	10:00	Consumer confidence – preliminary	Jan.	-14.4		-15.0	
Japan	18:50	Trade balance (¥B)	Dec.	-435.9		-408.9	
Japan	19:30	Composite PMI – preliminary	Jan.	n/a		50.0	
Japan	19:30	Manufacturing PMI – preliminary	Jan.	n/a		47.9	
Japan	19:30	Services PMI – preliminary	Jan.	n/a		51.5	
WEDNESDAY 24							
France	3:15	Composite PMI – preliminary	Jan.	45.2		44.8	
France	3:15	Manufacturing PMI – preliminary	Jan.	42.5		42.1	
France	3:15	Services PMI – preliminary	Jan.	46.0		45.7	
Germany	3:30	Composite PMI – preliminary	Jan.	47.8		47.4	
Germany	3:30	Manufacturing PMI – preliminary	Jan.	43.7		43.3	
Germany	3:30	Services PMI – preliminary	Jan.	49.0		49.3	
Eurozone	4:00	Composite PMI – preliminary	Jan.	48.0		47.6	
Eurozone	4:00	Manufacturing PMI – preliminary	Jan.	44.8		44.4	
Eurozone	4:00	Services PMI – preliminary	Jan.	49.0		48.8	
United Kingdom	4:30	Composite PMI – preliminary	Jan.	52.4		52.1	
United Kingdom	4:30	Manufacturing PMI – preliminary	Jan.	46.7		46.2	
United Kingdom	4:30	Services PMI – preliminary	Jan.	53.0		53.4	
THURSDAY 25							
France	2:45	Business confidence	Jan.	98		98	
France	2:45	Production outlook	Jan.	n/a		-10	
Germany	4:00	ifo Business Climate Index	Jan.	86.6		86.4	
Germany	4:00	ifo Current Assessment Index	Jan.	88.5		88.5	
Germany	4:00	ifo Expectations Index	Jan.	84.8		84.3	
Norway	4:00	Bank of Norway meeting	Jan.	4.50%		4.50%	
Eurozone	8:15	European Central Bank meeting	Jan.	4.50%		4.50%	
United Kingdom	19:01	Consumer confidence	Jan.	-21		-22	
Japan	18:30	Tokyo Consumer Price Index	Jan.		2.0%		2.4%
FRIDAY 26							
Japan	0:00	Leading indicator – final	Nov.	n/a		107.7	
Japan	0:00	Coincident index – final	Nov.	n/a		114.5	
Germany	2:00	Consumer confidence	Feb.	-24.8		-25.1	
France	2:45	Consumer confidence	Jan.	90		89	
Eurozone	4:00	M3 money supply	Dec.		-0.7%		-0.9%

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).