

WEEKLY COMMENTARY

It's Starting to Smell like a Recession

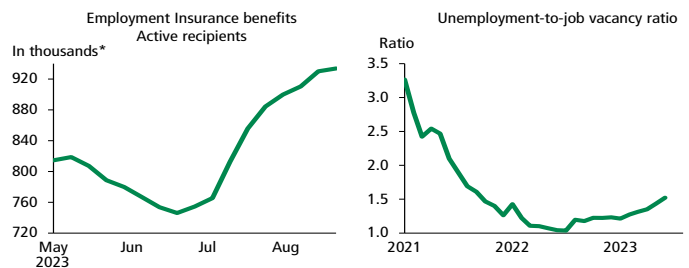
By Jimmy Jean, Vice-President, Chief Economist and Strategist

There's no need for provincial premiers to persuade the Bank of Canada to stop hiking. As we saw with the Q2 economic accounts, the data makes a compelling enough case. Not only did GDP growth miss the Bank of Canada's forecast by a wide stretch, but it registered a 0.2% contraction, the second in the last three quarters. Worse, Q1 growth was downwardly revised from 3.1% to 2.6%. Ironically, the consensus had penciled in a 2.5% outcome ahead of that release. This is noteworthy, as the seemingly robust Q1 figure was a pivotal factor motivating the Bank's decision to resume hikes in June.

So has the recession begun? It well may have, as once we factor the flat July flash estimate into our real-time GDP tracking, it points to another negative in Q3. And GDP wasn't the only piece of bad news this week. The recent Canadian bank earnings reports were downbeat, and not just because banks are increasing their provisions for credit losses, hampering their ability to meet analyst expectations. Lenders are increasingly focusing on optimizing their spending. It's no coincidence that within the finance and insurance sector, job vacancies dipped below their pre-pandemic averages in June, as per StatCan data released on Thursday. This is a trend worth monitoring, especially in Ontario and the Greater Toronto Area (GTA), where the financial industry has the biggest presence in Canada.

But the job market is also showing signs of weakness beyond the interest-sensitive financial industry. Economy-wide weekly Employment Insurance claims have surged by 34% since mid-June (graph). Considering the strong growth in the working-age population, it's reasonable to assume that the 0.5 percentage point increase in the jobless rate between May and July was just the beginning. This suggests that a Beveridge curve miracle – a phenomenon recently observed in the US where job vacancies were falling without a significant rise in the unemployment rate – might be elusive in Canada.

GRAPH
The Canadian Labour Market Is Trending Weaker



*Non-seasonally-adjusted
Sources : Government of Canada, Statistics Canada and Desjardins Economic Studies

This leads us to the intriguing question of how the markets are currently pricing the Bank of Canada's policy rate trajectory compared to the Federal Reserve's. Somewhat overlooked through all the talk of "higher-for-longer" interest rates this summer is the fact that a "higher-for-longer" outcome is being discounted more aggressively in Canada than in the US. As of this writing, investors were anticipating US rate cuts starting in Q1 2024, while they didn't expect the Bank of Canada to ease until mid-2024.

This is noteworthy given Canada's substantial exposure to mortgage rate renewals, an issue we have thoroughly analyzed, and which reappeared during the recent bank earnings season. Lenders reported another increase in the share of their mortgage portfolios featuring amortization periods exceeding 25 years. It's almost unheard of for buyers to extend their amortizations in the US, where Canadian-style variable-rate mortgages are uncommon. This means that the impact of higher interest rates is primarily felt by potential borrowers in the US, who can still opt to avoid entering into an expensive mortgage arrangement.

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NOTE TO READERS: The letters k, M and B are used in texts and tables to refer to thousands, millions and billions respectively.
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By contrast, in Canada, the repercussions of higher rates also extend to existing borrowers, who can't opt out of higher interest costs. In effect, a financial instrument once synonymous with promoting forced savings has now become associated with forced belt-tightening due to rising rates. That's why we are seeing consumers start to buckle, with even services consumption coming in flat in Q2. And for the Bank of Canada, it's a simple waiting game as the number of borrowers grappling with this situation continues to mount each month. The bottom line here is that there exists a noteworthy disparity in mortgage debt dynamics between Canada and the US, and markets may not be fully appreciating this distinction.

So where does this leave us ahead of Wednesday's decision? Assuming that the Bank of Canada places greater emphasis on economic activity and employment trends rather than relying on lagged indicators like sticky core inflation and wages, it's hard to justify pressing on with rate hikes. This is particularly true once we consider that the market has already tightened conditions significantly, as we can see from the 5-year Canadian bond yield recently reaching its highest level since 2007.

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

WEDNESDAY September 6 - 10:00

August

Consensus	52.4
Desjardins	52.7

July **52.7**

FRIDAY September 8 - 15:00

July **US\$B**

Consensus	16.000
Desjardins	12.000

June **17.847**

WEDNESDAY September 6 - 8:30

July **\$B**

Consensus	n/a
Desjardins	-4.10

June **-3.73**

WEDNESDAY September 6 - 10:00

September

Consensus	5.00%
Desjardins	5.00%

July 12 **5.00%**

FRIDAY September 8 - 8:30

August

Consensus	n/a
Desjardins	5,000

July **-6,400**

UNITED STATES

ISM Services index (August) – After falling to 50.3 in May, the ISM Services index made its way back up to 52.7 in July, as the service sector has continued to outperform manufacturing. We're not expecting the index reading to have moved much in August. While the main consumer confidence indexes have deteriorated, regional non-manufacturing indexes suggest some stability in the ISM Services index.

Consumer credit (July) – Consumer credit growth has remained relatively stable so far in 2023, although data from financial institutions points to a recent downtrend. We expect to see a weaker rise in credit growth for July, as high interest rates are likely to have put an end to the surge in term credit observed in June. But a drop in the US household savings rate in July suggests it won't have been a significant decline.

CANADA

International merchandise trade (July) – Canada's trade balance is expected to have increased relative to June. Meanwhile, exports likely fell on lower volumes as trade flows were impaired by a strike at British Columbia marine port terminals and severe flooding on Nova Scotia's rail network in July. While the extent of these disruptions has yet to be determined, they likely weighed disproportionately on exports.

Bank of Canada (September) – Expect the Bank of Canada to hold rates steady next week while it waits for more evidence to decide whether further rate hikes are warranted. Economic data came in weaker than the Bank expected in its July MPR. While inflation remains sticky above the 2% target, global factors, such as deflation in China and disinflation south of the border, are likely to ease domestic pressures going forward. The latest wave of monetary tightening has pushed real policy rates into positive territory while the recent tightening in financial conditions worldwide is yet another reason for the central bank to pause its rate hiking campaign. But even if the Bank decides to stay on the sidelines in September, the quantitative tightening program is set to accelerate in the coming months, which will continue to constrict policy at the margin.

Labour Force Survey (August) – The labour market is expected to show further signs of cooling, with a modest 5k gain in August. It is unclear whether several wildfires in various regions across Canada created any disruptions in the labour market, although any distortions would likely show up in the data as a drop in hours worked rather than the headline number. Upward pressure on the unemployment rate from accelerated population growth has largely been neutralized by strong employment gains. But with hiring expected to slow, unemployment should start drifting higher. We therefore expect the unemployment rate to have risen by 2 ticks to 5.7% in August. Meanwhile, wage growth should remain robust, but somewhat more muted than the YoY readings in July. Wages are nevertheless expected to persist at levels that would be inconsistent with the 2% inflation target.

FRIDAY September 8 - 21:30

August

Consensus

July

y/y


n/a


-0.3%**OVERSEAS**

China: Consumer Price Index (August) – July’s headline inflation print surprised by moving into negative territory. The producer price index followed a similar path, falling 0.3%. While deflation in China may have an upside (lower import prices) for other countries, it reveals the extent of China’s economic slowdown. So far, what little data we have for August doesn’t show any signs of improvement.

Economic Indicators

Week of September 4 to 8, 2023

Date	Time	Indicator	Period	Consensus		Previous reading
UNITED STATES						
MONDAY 4	---	Markets closed (Labor Day)				
TUESDAY 5	10:00	Factory orders (m/m)	July	-2.5%	-2.5%	2.3%
WEDNESDAY 6	8:30	Trade balance – goods and services (US\$B)	July	-68.0	-67.3	-65.5
	8:30	Speech by Federal Reserve Bank of Boston President S. Collins				
	10:00	ISM Services index	Aug.	52.4	52.7	52.7
	14:00	Release of the Beige Book				
	15:00	Speech by Federal Reserve Bank of Dallas President L. Logan				
THURSDAY 7	8:30	Initial unemployment claims	Aug. 28–Sept. 1	234,000	232,000	228,000
	8:30	Nonfarm productivity – final (ann. rate)	Q2	3.6%	3.3%	3.7%
	8:30	Unit labor costs – final (ann. rate)	Q2	1.7%	2.1%	1.6%
	10:00	Speech by Federal Reserve Bank of Philadelphia President P. Harker				
	11:45	Speech by Federal Reserve Bank of Chicago President A. Goolsbee				
	15:30	Speech by Federal Reserve Bank of New York President J. Williams				
	15:45	Speech by Federal Reserve Bank of Atlanta President R. Bostic				
	19:00	Speech by Federal Reserve Bank of Atlanta President R. Bostic				
	19:05	Speech by Federal Reserve Bank of Dallas President L. Logan				
FRIDAY 8	10:00	Wholesale inventories – final (m/m)	July	-0.1%	-0.1%	-0.1%
	15:00	Consumer credit (US\$B)	July	16.000	12.000	17.847
CANADA						
MONDAY 4	---	Markets closed (Labour Day)				
TUESDAY 5	---	---				
WEDNESDAY 6	8:30	International trade (\$B)	July	n/a	-4.10	-3.73
	8:30	Labour productivity (q/q)	Q2	n/a	-0.5%	-0.6%
	10:00	Bank of Canada meeting	Sept.	5.00%	5.00%	5.00%
THURSDAY 7	8:30	Building permits (m/m)	July	n/a	-2.4%	6.1%
	13:55	Speech by Bank of Canada Governor T. Macklem				
FRIDAY 8	8:30	Net change in employment	Aug.	n/a	5,000	-6,400
	8:30	Unemployment rate	Aug.	n/a	5.7%	5.5%
	8:30	Industrial capacity utilization rate	Q2	n/a	83.7%	81.9%

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 Daylight Time (GMT - 4 hours).  Desjardins Economic Studies forecast.

Economic Indicators

Week of September 4 to 8, 2023

Country	Time	Indicator	Period	Consensus		Previous reading		
				m/m (q/q)	y/y	m/m (q/q)	y/y	
OVERSEAS								
MONDAY 4								
Germany	2:00	Trade balance (€B)	July	17.8		18.7		
Japan	20:30	Composite PMI – final	Aug.	n/a		52.6		
Japan	20:30	Services PMI – final	Aug.	n/a		54.3		
TUESDAY 5								
Australia	0:30	Reserve Bank of Australia meeting	Sept.	4.10%		4.10%		
Italy	3:45	Composite PMI	Aug.	48.1		48.9		
Italy	3:45	Services PMI	Aug.	50.5		51.5		
France	3:50	Composite PMI – final	Aug.	46.6		46.6		
France	3:50	Services PMI – final	Aug.	46.7		46.7		
Germany	3:55	Composite PMI – final	Aug.	44.7		44.7		
Germany	3:55	Services PMI – final	Aug.	47.3		47.3		
Eurozone	4:00	Composite PMI – final	Aug.	47.0		47.0		
Eurozone	4:00	Services PMI – final	Aug.	48.3		48.3		
United Kingdom	4:30	Composite PMI – final	Aug.	47.9		47.9		
United Kingdom	4:30	Services PMI – final	Aug.	48.7		48.7		
Eurozone	5:00	Producer price index	July	-0.5%	-7.5%	-0.4%	-3.4%	
WEDNESDAY 6								
China	---	Trade balance (US\$B)	Aug.	67.68		80.60		
Germany	2:00	Factory orders	July	-4.0%	-3.9%	7.0%	3.0%	
United Kingdom	4:30	Construction PMI	Aug.	50.0		51.7		
Eurozone	5:00	Retail sales	July	-0.1%	-1.2%	-0.3%	-1.4%	
THURSDAY 7								
Japan	1:00	Leading indicator – preliminary	July	107.8		108.9		
Japan	1:00	Coincident index – preliminary	July	114.2		115.1		
France	1:30	Wages – final	Q2	n/a		1.0%		
Germany	2:00	Industrial production	July	-0.4%	-2.1%	-1.5%	-1.7%	
France	2:45	Trade balance (€M)	July	n/a		-6,713		
France	2:45	Current account (€B)	July	n/a		0.8		
Italy	4:00	Retail sales	July	0.2%	n/a	-0.2%	3.6%	
Eurozone	5:00	Net change in employment – final	Q2	n/a	n/a	0.2%	1.5%	
Eurozone	5:00	Real GDP – final	Q2	0.3%	0.6%	0.3%	0.6%	
Japan	19:50	Current account (¥B)	July	2,182.5		2,345.9		
Japan	19:50	Real GDP – final	Q2	1.4%		1.5%		
FRIDAY 8								
Germany	2:00	Consumer price index – final	Aug.	0.3%	6.1%	0.3%	6.1%	
France	2:45	Industrial production	July	0.1%	1.3%	-0.9%	-0.3%	
China	21:30	Consumer price index	Aug.		n/a		-0.3%	
China	21:30	Producer price index	Aug.		n/a		-4.4%	

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 Daylight Time (GMT - 4 hours).