

WEEKLY COMMENTARY

Please note that there will be no release of the *Weekly Commentary* from June 30 to August 4, 2023 inclusive.

The New Normal

By Royce Mendes, Managing Director and Head of Macro Strategy

At some point, it will be appropriate for central banks to begin cutting interest rates. The timing and extent of such reductions, though, remains an open question. Central bankers have yet to return inflation to the low and stable trend that prevailed for so many years before COVID. That's the first order of business. While inflation is well off the peaks of last year, there are signs that underlying price-setting dynamics are becoming lodged at around 4%. That's double both the Bank of Canada and US Federal Reserve's inflation targets.

But monetary policy takes time to work. With some additional policy tightening and likely at least a short recession, inflation can be brought to heel. At that point, the current levels of interest rates won't be required. As central bankers begin thinking about reducing rates next year, they will be cognizant of not easing so much that they spark another run of excess inflation again. As a result, they will wait longer and want to see more economic weakness before reversing any of their rate hikes. Eventual rate cuts will also be delivered at a slower pace than in prior cycles to avoid easing too much. As the old saying goes, officials would rather make a new mistake than make the last mistake again. That means being overly cautious about stimulating inflationary pressures.

Central bankers also need to contend with the new dynamics affecting interest rates. Secular trends will add to the reasons for policymakers to avoid cutting rates as much as they might have during previous recessions. Surging population growth in Canada as a result of net migration means that the individual hardships of households brought on by high interest rates won't be as much of a drag on economic activity. As new residents are introduced, their spending will help support the economy.

Separately, efforts to reshore critical manufacturing capacity and transition to greener energy sources will require massive capital investments. That's another source of economic strength that wasn't as prevalent pre-COVID. Together, these will mean that interest rates don't need to fall to as low as they had been to generate economic growth.

We've written extensively on the subject, and central bankers are beginning to warm up to the idea of higher so-called "neutral interest rates," which is the policy setting that keeps the economy from operating too hot or too cold. Just a couple of weeks ago, Bank of Canada Deputy Governor Paul Beaudry outlined similar reasoning as to why interest rates are likely to settle towards the higher rather than the lower end of their published 2.00% to 3.00% estimated neutral rate range.

In the US, while Fed officials continue to pencil in a policy rate of 2.50% for the longer term, the central tendency around that forecast is creeping up. Monetary policymakers tend to make slow and deliberate changes to their fundamental views of the world. Look no further than the pre-COVID years when markets were forecasting falling neutral rates, but central banks were late to make any changes to their official forecasts. Once again it looks like markets are leading the charge, pricing in longer-term rates that would have been considered very restrictive only a few years ago. But that just reflects the new normal environment we live in.

CONTENT

Musing of the Week	1	What to Watch For	3	Economic Indicators	4
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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, Francis Généreux, Principal Economist, Marc-Antoine Dumont, Economist and Maëlle Boulais-Préseault, Economist

TUESDAY, June 27 - 8:30

May	m/m
Consensus	-0.9%
Desjardins	0.3%
April	1.1%

TUESDAY, June 27 - 9:00

April	y/y
Consensus	-1.2%
Desjardins	-2.6%
March	-1.2%

TUESDAY, June 27 - 10:00

May	ann. rate
Consensus	670,000
Desjardins	700,000
April	683,000

TUESDAY, June 27 - 10:00

June	Index
Consensus	104.0
Desjardins	105.0
May	102.3

FRIDAY, June 30 - 8:30

May	m/m
Consensus	0.2%
Desjardins	0.2%
April	0.0%

UNITED STATES

Durable goods orders (May) – Durable goods orders rose 1.1% in April, primarily on the back of a surge in military aircraft orders. We think this sector contracted in May, although total transportation orders probably advanced. Data from Boeing suggest an increase in nondefense aircraft, while automotive orders likely inched up. We’re expecting a modest 0.1% decrease excluding transportation on the heels of a larger 0.3% fall in April. The weakness in the new orders component of the ISM Manufacturing index—which dropped to 42.6 in May—suggests further contraction. We’re anticipating 0.3% growth in durable goods orders overall.

S&P/Case Shiller index of existing home prices (April) – Despite a positive month-over-month print in March, the Case-Shiller index suffered its first year-over-year decline since May 2012. The same thing probably happened in April. We’re expecting another positive month that reflects the improvement in other housing market indicators, including growth in sales amid limited supply. We’re forecasting a monthly gain of 0.2%, but a year-over-year drop of 2.6%.

New home sales (May) – Sales of new homes rose for the sixth time in seven months in April, which is surprising given the high interest rate environment. In addition, based on the 4.8% increase in building permits for single-family homes, sales likely came in higher again in May, at 700,000 units. That said, mortgage rates started to rise again in late April and loan applications have fallen, so there are some downside risks to our forecast and to future sales trends.

Conference Board consumer confidence index (June) – The Conference Board index dipped 1.4 points in May after shedding 0.3 points in April. Part of this decline was probably due to concerns over US debt ceiling negotiations. Now that the situation has been resolved, at least until 2025, we’re expecting to see a positive impact. The major stock indexes are also up this month, despite some days in the red recently. Gasoline prices have been relatively stable. The preliminary University of Michigan consumer sentiment index also rose in June. As a result, we expect the Conference Board’s confidence index to improve to 105.0.

Consumer spending (May) – Real consumer spending had its best month since January in April. The gain came primarily from the automotive sector, but the other components performed well too. Growth was probably weaker or flat in May. The number of new motor vehicles sold in May decreased, while retail sales also declined. Lower energy production also indicates relatively weak spending on services. While real consumer spending likely stagnated, we’re forecasting a 0.2% increase in nominal consumption.

TUESDAY, June 27 - 8:30

May	m/m
Consensus	0.4%
Desjardins	0.4%
April	0.7%

FRIDAY, June 30 - 8:30

April	m/m
Consensus	0.2%
Desjardins	0.2%
March	0.0%

THURSDAY, June 29 - 21:30

June	Index
Consensus	n/a
May	52.9

FRIDAY, June 30 - 5:00

June	y/y
Consensus	5.6%
May	6.1%

CANADA

Consumer Price Index (May) – The 12-month pace of inflation looks to have sunk like a stone in May. Our 3.4% forecast would be the slowest year-over-year rate of growth since mid-2021, when the word “transitory” was being used to describe burgeoning consumer price increases. That said, most of the decline in the annual rate was the result of base effects, with a very strong monthly print falling out of the 12-month calculation. It’s therefore more important to focus on the recent trend in consumer price growth, which remains strong. We see the headline price index having increased 0.4% in May. Energy prices likely declined, but food prices probably climbed once again. Excluding food and energy, we expect consumer prices rose 0.3% in seasonally adjusted terms. That’s inconsistent with the Bank of Canada’s 2% inflation target. Three-month annualized rates of other underlying inflation measures have been stuck in a range between 3.5% and 4.5%. We expect them to have remained in that range in May, reinforcing the need to see interest rates move even higher.

Real GDP by industry (April) – After a couple of lacklustre prints in February and March, real GDP by industry is expected to have picked back up in April. Our forecast of a 0.2% advance in the month is in line with Statistics Canada’s flash estimate, although we think there is some upside to this outlook. Looking under the hood, goods-producing sectors are anticipated to have led the charge forward, particularly given a rebound in mining and oil and gas extraction but also respectable gains in construction and manufacturing. Not surprisingly, real estate and leasing should be top of the leaderboard in services-producing sectors given the rebound in sales transactions in April. But this likely wasn’t enough to entirely offset the sharp drop in wholesale trade in the cruellest month, while other categories were probably more mixed but modest in terms of gains and losses. Looking ahead to May, we’re expecting another print of around 0.2% in the month thanks to sustained activity in housing and retail sales, but also broad-based gains generally. If the Bank of Canada is looking for a slowdown in activity in May, it will likely need to search elsewhere.


OVERSEAS


China: Composite PMI (June) – PMIs were down again in May, indicating that the economic rebound is clearly running out of steam. The manufacturing sector continues to be hobbled by the slowdown in global goods consumption, and the index is expected to remain below 50 in June. However, growth in the services component could signal the start of a recovery in domestic demand. June’s PMIs will give us a better idea of how severe China’s economic slowdown is and which sectors are impacted.

Eurozone: Consumer Price Index (June – preliminary) – Although inflation remains high in the eurozone at 6.1% in May, it has improved from its peak of 10.6% in October 2022. That said, inflationary pressure remains acute, as evidenced by the slower progress we’re seeing in the all items less food and energy index. Core inflation was 5.3% in May, which is alarmingly close to its peak of 5.6%. June’s preliminary data will reveal whether the trend of softer headline and sticky core inflation has continued.

Economic Indicators

Week of June 26 to 30, 2023

Day	Time	Indicator	Period	Consensus		Previous reading
UNITED STATES						
SUNDAY 25	9:15	Speech by Federal Reserve Bank of New York President J. Williams				
MONDAY 26	---	---				
TUESDAY 27	8:30	Durable goods orders (m/m)	May	-0.9%	0.3%	1.1%
	9:00	S&P/Case-Shiller home price index (y/y)	April	-1.2%	-2.6%	-1.1%
	10:00	New home sales (ann. rate)	May	670,000	700,000	683,000
	10:00	Consumer confidence	June	104.0	105.0	102.3
WEDNESDAY 28	8:30	Goods trade balance – preliminary (US\$B)	May	-93.2	-90.1	-96.8
	8:30	Retail inventories (m/m)	May	n/a	n/a	0.2%
	8:30	Wholesale inventories – preliminary (m/m)	May	-0.1%	n/a	-0.1%
	9:30	Speech by Federal Reserve Chair J. Powell				
THURSDAY 29	2:30	Speech by Federal Reserve Chair J. Powell				
	6:00	Speech by Federal Reserve Bank of Atlanta President R. Bostic				
	8:30	Initial unemployment claims	June 19–24	266,000	267,000	264,000
	8:30	Real GDP – third estimate (ann. rate)	Q1	1.4%	1.3%	1.3%
FRIDAY 30	8:30	Personal income (m/m)	May	0.4%	0.3%	0.4%
	8:30	Personal consumption expenditures (m/m)	May	0.2%	0.2%	0.8%
	8:30	Personal consumption expenditures deflator				
		Total (m/m)	May	0.1%	0.1%	0.4%
		Excluding food and energy (m/m)	May	0.4%	0.3%	0.4%
		Total (y/y)	May	3.8%	3.8%	4.4%
		Excluding food and energy (y/y)	May	4.7%	4.6%	4.7%
	9:45	Chicago PMI	June	44.0	45.0	40.4
	10:00	University of Michigan consumer sentiment index – final	June	63.9	63.9	63.9
CANADA						
MONDAY 26	---	Quebec National Holiday				
TUESDAY 27	---	---				
WEDNESDAY 28	5:30	Speech by Bank of Canada Deputy Governor S. Kozicki				
	8:30	Consumer price index				
		Total (m/m)	May	0.4%	0.4%	0.7%
		Total (y/y)	May	3.4%	3.4%	4.4%
THURSDAY 29	---	---				
FRIDAY 30	8:30	Real GDP by industry (m/m)	April	0.2%	0.2%	0.0%
	10:30	Release of the Bank of Canada's Business Outlook Survey				

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 daylight saving time (GMT - 4 hours).  Desjardins Economic Studies forecast.

Economic Indicators

Week of June 12 to 16, 2023

Country	Time	Indicator	Period	Consensus		Previous reading		
				m/m (q/q)	y/y	m/m (q/q)	y/y	
OVERSEAS								
MONDAY 26								
Germany	4:00	ifo Business Climate Index	June	90.6		91.7		
Germany	4:00	ifo Current Assessment Index	June	93.5		94.8		
Germany	4:00	ifo Expectations Index	June	88.1		88.6		
TUESDAY 27								
Italy	4:00	Consumer confidence	June	105.5		105.1		
WEDNESDAY 28								
Germany	2:00	Consumer confidence	July	-23.0		-24.2		
France	2:45	Consumer confidence	June	84		83		
Eurozone	4:00	M3 money supply	May		1.5%		1.9%	
Italy	5:00	Consumer price index – preliminary	June	0.3%	6.8%	0.3%	7.6%	
Japan	19:50	Retail sales	May	0.8%	5.2%	-1.1%	5.1%	
THURSDAY 29								
Japan	1:00	Consumer confidence	June	36.1		36.0		
Sweden	3:30	Bank of Sweden meeting	June	3.75%		3.50%		
Eurozone	5:00	Consumer confidence – final	June	n/a		-16.1		
Eurozone	5:00	Economic confidence	June	96.0		96.5		
Eurozone	5:00	Industrial confidence	June	-5.6		-5.2		
Eurozone	5:00	Services confidence	June	5.1		7.0		
Germany	8:00	Consumer price index – preliminary	June	0.2%	6.3%	-0.1%	6.1%	
Japan	19:30	Unemployment rate	May	2.6%		2.6%		
Japan	19:30	Tokyo Consumer Price Index	June		3.4%		3.2%	
Japan	19:50	Industrial production – preliminary	May	-1.0%	4.4%	0.7%	-0.7%	
China	21:30	Composite PMI	June	n/a		52.9		
China	21:30	Manufacturing PMI	June	49.0		48.8		
China	21:30	Non-manufacturing PMI	June	53.7		54.5		
FRIDAY 30								
Japan	1:00	Housing starts	May		-2.4%		-11.9%	
Germany	2:00	Retail sales	May	0.0%	-4.9%	0.5%	-8.7%	
United Kingdom	2:00	Nationwide house prices	June	-0.3%	-4.0%	-0.1%	-3.4%	
United Kingdom	2:00	Real GDP – final	Q1	0.1%	0.2%	0.1%	0.2%	
France	2:45	Personal consumption expenditures	May	0.6%	-3.6%	-1.0%	-4.3%	
France	2:45	Consumer price index – preliminary	June	0.2%	4.6%	-0.1%	5.1%	
France	2:45	Producer price index	May	n/a	n/a	-5.1%	7.0%	
Italy	4:00	Unemployment rate	May	7.9%		7.8%		
Eurozone	5:00	Consumer price index – preliminary	June	0.3%	5.6%	0.0%	6.1%	
Eurozone	5:00	Unemployment rate	May	6.5%		6.5%		

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 daylight saving time (GMT - 4 hours).