

WEEKLY COMMENTARY

Will Tighter Credit Conditions Hurt Economic Growth?

By Francis Généreux, Principal Economist

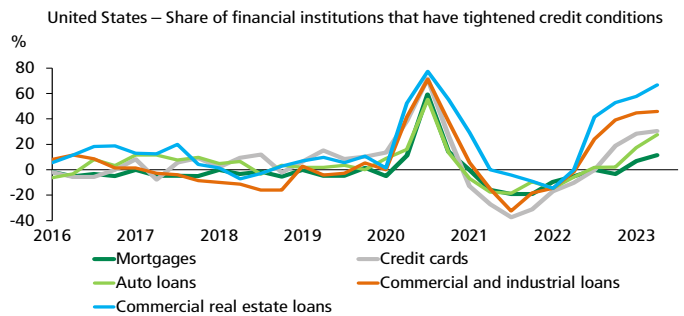
Despite some weakness and uncertainty, the economy has been resilient thus far. Growth remains relatively strong in the face of more than a year of interest rate hikes. But according to our forecast, monetary tightening will eventually take a toll on economic activity and the labour market.

One way monetary policy can affect economic growth is by tightening credit conditions. When their borrowing costs go up, financial institutions tend to be more circumspect about lending. This is especially true when there's uncertainty about a slowing economy and a risk of deteriorating household and business finances, which could make it harder for customers to pay back their loans. Financial institutions may also be wary of industries or regions that are harder hit than others. Then there are concerns about bank liquidity, loan portfolio values and deposit outflows, which could prompt greater caution.

US banking turmoil in the wake of the Silicon Valley Bank collapse in mid-March and other failures may have further restricted credit conditions. According to the quarterly Senior Loan Officer Opinion Survey, after starting to tighten in 2022, US credit conditions have become much more restrictive. The reasons for this include a less favourable or more uncertain economic outlook, reduced tolerance for risk, deterioration in collateral values and concerns about banks' funding costs and liquidity positions.

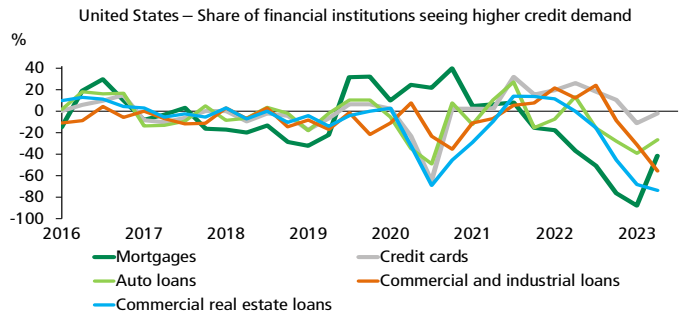
US banks have responded by restricting credit to consumers and businesses alike (graph 1). This can look very different depending on the type of loan. Most commonly, financial institutions will increase the spread between their cost of funds and the interest rate they charge borrowers. They may also tighten their lending standards or require installment payments or more collateral. Combined with higher interest rates, this makes borrowing less

GRAPH 1
US Financial Institutions Are Tightening Credit Conditions



Sources: Federal Reserve Board and Desjardins Economic Studies

GRAPH 2
Loan Applications Are Down



Sources: Federal Reserve Board and Desjardins Economic Studies

attractive for households and businesses. Financial institutions are also reporting a significant drop in credit demand (graph 2).

CONTENT

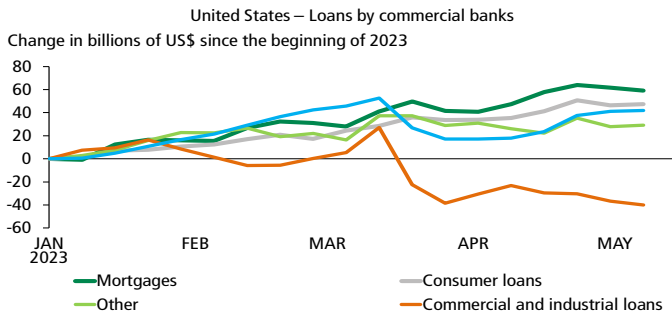
Musing of the Week 1 What to Watch For 3 Economic Indicators 5

NOTE TO READERS: The letters k, M and B are used in texts and tables to refer to thousands, millions and billions respectively. IMPORTANT: This document is based on public information and may under no circumstances be used or construed as a commitment by Desjardins Group. While the information provided has been determined on the basis of data obtained from sources that are deemed to be reliable, Desjardins Group in no way warrants that the information is accurate or complete. The document is provided solely for information purposes and does not constitute an offer or solicitation for purchase or sale. Desjardins Group takes no responsibility for the consequences of any decision whatsoever made on the basis of the data contained herein and does not hereby undertake to provide any advice, notably in the area of investment services. Data on prices and margins is provided for information purposes and may be modified at any time based on such factors as market conditions. The past performances and projections expressed herein are no guarantee of future performance. Unless otherwise indicated, the opinions and forecasts contained herein are those of the document's authors and do not represent the opinions of any other person or the official position of Desjardins Group. Copyright © 2023, Desjardins Group. All rights reserved.

Normally when conditions are this tight and credit demand is this low, loan volumes and economic growth fall off sharply. We're not seeing this yet, which is why the US economy seems surprisingly resilient.

Even the financial turbulence that began in March has had much less of an impact than many analysts predicted. The failure of Silicon Valley Bank and trouble at other financial institutions, along with concerns about regional banks and deposit outflows, have triggered fears of a credit crunch. But while business loans by commercial banks are way down, household credit isn't. And business loans have just about stabilized following the initial drop (graph 3).

GRAPH 3
Business Loans Are Down More than Other Loan Types since Mid-March



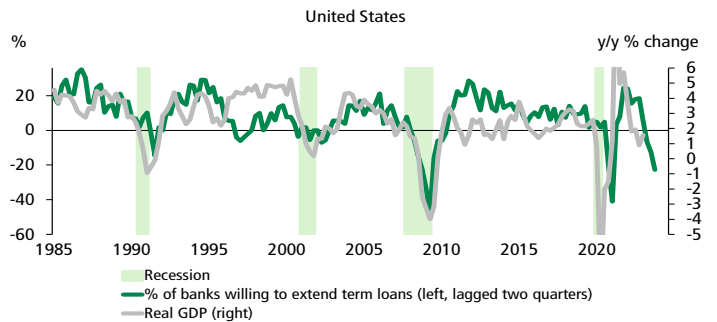
Sources: Federal Reserve Board and Desjardins Economic Studies

While things could have been much worse, it's too soon to declare victory. It's clear from the Fed's Senior Loan Officer Opinion Survey that US banks expect to tighten standards further across all loan categories over the remainder of 2023. That's primarily due to an expected deterioration in the credit quality of their loan portfolios and in customers' collateral values, a reduction in risk tolerance, and concerns about bank funding costs, bank liquidity positions and deposit outflows.

Credit conditions are already fairly restrictive, so additional tightening should eventually take a toll on economic growth. But economic growth and credit may move in opposite directions for a while. Thanks to federal pandemic assistance, households have been able to rely less on credit and pay down a lot of debt. Excess savings and strong wage growth have also provided a cushion. But the ongoing tightening of credit conditions will hurt growth. In fact, every time banks have been this stingy with lending, the US has dipped into a recession (graph 4).

The same is true in other advanced economies. Inflation has spiked around the world, leading to higher interest rates in most major economies. And banking concerns have spread beyond US borders, with loan officer surveys showing tighter credit and financial conditions in the UK, the eurozone and Canada

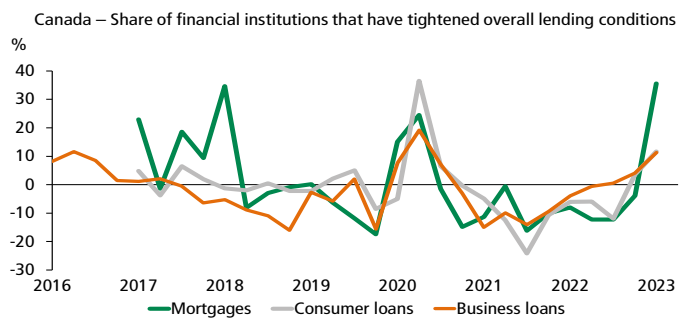
GRAPH 4
Reluctant Lenders Don't Bode Well for Economic Growth



Sources: Federal Reserve Board, Bureau of Economic Analysis, National Bureau of Economic Research and Desjardins Economic Studies

(graph 5). So despite its resilience, the economy should eventually feel the effects of higher interest rates and reluctant lenders. It's one reason we could see a few quarters of economic contraction. Another would be a failure to raise the US [debt ceiling](#), leading to a government default.

GRAPH 5
Canadian Financial Institutions Are Also Tightening Credit Conditions



Sources: Bank of Canada and Desjardins Economic Studies

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, May 30 - 9:00

March	y/y
Consensus	n/a
Desjardins	-1.8%
February	0.4%

TUESDAY, May 30 - 10:00

May	Index
Consensus	99.5
Desjardins	99.0
April	101.3

THURSDAY, June 1 - 10:00

May	Index
Consensus	47.1
Desjardins	46.3
April	47.1

FRIDAY, June 2 - 8:30

May	
Consensus	188,000
Desjardins	190,000
April	253,000

TUESDAY, May 30 - 8:30

Q1 2023	\$B
Consensus	-10.2
Desjardins	-7.9
Q4 2022	-10.6

WEDNESDAY, May 31 - 8:30

Q1 2023	ann. rate
Consensus	1.8%
Desjardins	2.9%
Q4 2022	0.0%

UNITED STATES

S&P/Case-Shiller index of existing home prices (March) – The S&P/Case-Shiller index edged up 0.1% in February. However, we expect this first increase since June 2022 to be immediately followed by another slump, likely of -0.2% in March. That would be enough to put the year-over-year change in home prices in the red for the first time since 2012. We're forecasting a 12-month decline of 1.8%.

Conference Board consumer confidence index (May) – Consumer sentiment as measured by the Conference Board fell in April to its lowest level since July 2022. Another dip is likely in May as concerns over debt ceiling negotiations become increasingly acute. Additionally, the University of Michigan consumer sentiment index and the TIPP index saw their biggest declines in almost a year and since April 2020, respectively. The stock market is also down as investors are concerned that the US federal government could default on its payments and that inflation is too sticky for the Federal Reserve to call time on its monetary tightening. However, lower gasoline prices over the last few weeks could offer some support. The Conference Board index may still fall beneath the 100 mark this month.

ISM Manufacturing index (May) – The ISM Manufacturing index has been hovering around 47.0 since the beginning of the year. After falling to 46.3 in March, it rose to 47.1 in April. Based on the regional manufacturing indexes published to date, it likely dropped to 46.3 in May. This would keep the index firmly camped under the 50 mark, signalling a contraction in manufacturing activity.

Job creation according to the establishment survey (May) – Job creation remained robust in the United States in April. Downward adjustments to the two previous months' prints somewhat mitigated the surprise 253,000 jobs added in April. We expect the trend to have slowed again in May. The recent increase in unemployment claims points to slower job growth, and the number of open positions has also dropped since the beginning of the year. As such, we're forecasting that May's print will show just under 200,000 jobs added and the unemployment rate edging up to 3.5%.

CANADA

Current account (Q1 2023) – Canada's current account deficit is expected to have narrowed in the first quarter of 2023, as the investment income balance likely improved on the rebound in financial asset values. In contrast, the goods trade surplus is estimated to have shrunk while the services trade deficit looks to have expanded in the quarter.

Real GDP by expenditure (Q1 2023) – Real GDP growth is expected to have surged ahead by 2.9% annualized in the first quarter of 2023 after stalling in Q4 2022. This is higher than the Bank of Canada's (BoC's) 2.3% forecast published in its April 2023 Monetary Policy Report. Underpinning our robust call is the strength of household consumption, with Q1 data suggesting auto sales and consumer services had a strong quarter. Exports also spiked in the first quarter of the year, well offsetting the drag from imports. The contribution from business investment is expected to be positive, offsetting the sustained weakness in residential investment. Finally, inventories are likely to hold back growth again in Q1, albeit not to the outsized extent witnessed in Q4 2022. That said, there is a risk that we may be overestimating the downdraft from inventories, which suggests there may be some upside to our already-above-BoC call.

WEDNESDAY, May 31 - 8:30

March	m/m
Consensus	-0.1%
Desjardins	0.0%
February	0.1%

TUESDAY, May 30 - 21:30

May	Index
Consensus	n/a
April	54.4

THURSDAY, June 1 - 5:00

May	y/y
Consensus	6.3%
April	7.0%

Real GDP by industry (March) – Real GDP by industry is expected to have stalled in March, as goods- and services-producing sectors are both anticipated to have remained broadly flat. Notably, this weak estimate is still modestly more optimistic than Statistics Canada’s flash estimate of -0.1% in the month. On the goods side, advances in mining and oil and gas extraction as well as manufacturing are likely to have been largely offset by weakness elsewhere. In services-producing sectors, an outsized contraction in retail sales volumes and more modest declines in other sectors are projected to be offset by more modest gains elsewhere. Looking ahead to the April flash estimate, we’re looking for a contraction of about 0.2% in the month, as robust gains in resource sector activity were probably more than offset by the drag from the federal public service strike and ice storms in Central Canada.


OVERSEAS


China: Composite PMI (May) – Initial signs that the economic rebound is running out of steam appeared in April as industrial production, retail sales and PMI indexes underperformed. Pressure is expected to continue in the manufacturing sector as global goods consumption declines, but the construction and services sectors could signal a rebound in Chinese domestic demand. May’s data will tell us if last month’s PMI declines were just a blip, or if this is a more persistent slowdown.

Eurozone: Consumer Price Index (May, preliminary) – Inflation increased in the eurozone in April for the first time since September 2022. Year-over-year, the all items index rose from 6.8% in March to 7.0% in April. Recent monthly prints for the all items index and the core index excluding energy, food, alcohol and tobacco products have been rather sticky. May’s preliminary data will show us whether inflation remains stubborn or a softening trend has resumed.

Economic Indicators

Week of May 29 to June 2, 2023

Day	Time	Indicator	Period	Consensus		Previous reading
UNITED STATES						
MONDAY 29	---	Markets closed (Memorial Day)				
TUESDAY 30	9:00	S&P/Case-Shiller home price index (y/y)	March	n/a	-1.8%	0.4%
	10:00	Consumer confidence	May	99.5	99.0	101.3
	13:00	Speech by Federal Reserve Bank of Richmond President T. Barkin				
WEDNESDAY 31	8:50	Speech by Federal Reserve Bank of Boston President S. Collins and by Federal Reserve Governor M. Bowman				
	9:45	Chicago PMI	May	47.5	46.5	48.6
	12:30	Speech by Federal Reserve Bank of Philadelphia President P. Harker				
	13:30	Speech by Federal Reserve Governor P. Jefferson				
	14:00	Release of the Beige Book				
THURSDAY 1	8:30	Initial unemployment claims	May 22–26	235,000	234,000	229,000
	8:30	Nonfarm productivity – final (ann. rate)	Q1	-2.7%	-2.4%	-2.7%
	8:30	Unit labor costs – final (ann. rate)	Q1	6.3%	6.0%	6.3%
	10:00	Construction spending (m/m)	April	0.2%	0.4%	0.3%
	10:00	ISM Manufacturing index	May	47.1	46.3	47.1
	13:00	Speech by Federal Reserve Bank of Philadelphia President P. Harker				
	---	Total vehicle sales (ann. rate)	May	15,350,000	15,000,000	15,910,000
FRIDAY 2	8:30	Change in nonfarm payrolls	May	188,000	190,000	253,000
	8:30	Unemployment rate	May	3.5%	3.5%	3.4%
	8:30	Average hourly earnings (m/m)	May	0.3%	0.2%	0.5%
	8:30	Average weekly hours	May	34.4	34.4	34.4
CANADA						
MONDAY 29	---	---				
TUESDAY 30	8:30	Current account balance (\$B)	Q1	-10.2	-7.9	-10.6
WEDNESDAY 31	8:30	Real GDP (ann. rate)	Q1	1.8%	2.9%	0.0%
	8:30	Real GDP by industry (m/m)	March	-0.1%	0.0%	0.1%
THURSDAY 1	---	---				
FRIDAY 2	---	---				

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 May 29 to June 2, 2023

Country	Time	Indicator	Period	Consensus		Previous reading		
				m/m (q/q)	y/y	m/m (q/q)	y/y	
OVERSEAS								
MONDAY 29								
Japan	1:00	Coincident index – final	March	n/a		98.8		
Japan	1:00	Leading indicator – final	March	n/a		97.7		
Japan	19:30	Unemployment rate	April	2.7%		2.8%		
TUESDAY 30								
Eurozone	4:00	M3 money supply	April		2.0%		2.5%	
Eurozone	5:00	Consumer confidence – final	May	-17.4		-17.4		
Eurozone	5:00	Economic confidence	May	99.0		99.3		
Eurozone	5:00	Industrial confidence	May	-3.6		-2.6		
Eurozone	5:00	Services confidence	May	10.2		10.5		
Japan	19:50	Retail sales	April	0.6%	7.1%	0.6%	7.2%	
Japan	19:50	Industrial production – preliminary	April	1.4%	1.9%	1.1%	-0.6%	
China	21:30	Composite PMI	May	n/a		54.4		
China	21:30	Manufacturing PMI	May	49.5		49.2		
China	21:30	Non-manufacturing PMI	May	55.0		56.4		
WEDNESDAY 31								
Japan	1:00	Housing starts	April		-0.8%		-3.2%	
Japan	1:00	Consumer confidence	May	36.0		35.4		
France	2:45	Real GDP – final	Q1	0.2%	0.8%	0.2%	0.8%	
France	2:45	Personal consumption expenditures	April	0.3%	-3.7%	-1.3%	-4.2%	
France	2:45	Consumer price index – preliminary	May	0.3%	5.5%	0.7%	6.9%	
France	2:45	Producer price index	April	n/a	n/a	2.0%	12.9%	
Italy	4:00	Real GDP – final	Q1	0.5%	1.8%	0.5%	1.8%	
Italy	5:00	Consumer price index – preliminary	May	-0.2%	7.2%	0.5%	8.3%	
Germany	8:00	Consumer price index – preliminary	May	0.2%	6.4%	0.4%	7.2%	
Japan	20:30	Manufacturing PMI – final	May	n/a		50.8		
THURSDAY 1								
Germany	2:00	Retail sales	April	1.0%	-5.8%	-2.4%	-6.5%	
United Kingdom	2:00	Nationwide house prices	May	-0.5%	-3.7%	0.5%	-2.7%	
Italy	3:45	Manufacturing PMI	May	45.8		46.8		
France	3:50	Manufacturing PMI – final	May	46.1		46.1		
Germany	3:55	Manufacturing PMI – final	May	42.9		42.9		
Eurozone	4:00	Manufacturing PMI – final	May	44.6		44.6		
Italy	4:00	Unemployment rate	April	7.8%		7.8%		
United Kingdom	4:30	Manufacturing PMI – final	May	46.9		46.9		
Eurozone	5:00	Consumer price index – preliminary	May	0.2%	6.3%	0.6%	7.0%	
Eurozone	5:00	Unemployment rate	April	6.5%		6.5%		
FRIDAY 2								
France	2:45	Industrial production	April	0.3%	1.4%	-1.1%	-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 daylight saving time (GMT - 4 hours).