WEEKLY COMMENTARY

Bank of Canada Slowing Down, but Not Pulling Over Yet

By Royce Mendes, Managing Director and Head of Macro Strategy

Canadian central bankers will have had seven weeks to mull over whether rates need to be pushed even higher. A host of economic data has been released over that period, so there was a lot to digest. However, focusing on the metrics that the Bank of Canada has highlighted in recent communications, it doesn't seem like enough progress has been made to hit the pause button next week.

It's true that housing markets have continued to stumble and shoppers didn't spend particularly lavishly during the holiday season. Both of those can be chalked up to rising interest rates. Headline inflation has also fallen from 6.9% in October to 6.3% in December. While that's mostly been an energy and supply chain story, that's material progress in a short amount of time.

Lags in monetary policy suggest that further slowing in activity and inflation will occur as a result of past rate hikes. The problem is there's not enough evidence to confidently say that inflation is clearly on its way back to the 2% target.

Super core measures of inflation have been rangebound for the past three months at around 4%. Back in October, when these indicators had first fallen to 4%, the Bank of Canada said it wanted to see them decelerate further. The central bank reiterated in December that to declare meaningful progress had been made towards the 2% target, those super core measures would need to slow even more. That hasn't happened.

Inflation expectations also remain uncomfortably high. Despite falling gasoline prices, Canadian consumers still believe inflation will be tracking 7% over the coming year, virtually unchanged from their responses three months earlier. It's the same story for inflation expectations over the next two years, which remained stubbornly high at 5%.

Businesses similarly lack faith in the Bank of Canada's ability to control inflation. Less than 10% of those surveyed by the central bank see inflation in the neighbourhood of 2% this year, and 40% see it taking until 2026 or later to restore price stability. The Bank of Canada has highlighted elevated inflation expectations as a source of concern.

The central bank's waning credibility with regards to its inflation mandate has to be very unsettling for monetary policymakers. In light of the fact that Governing Council likely had a sneak peek at these survey results ahead of its last rate announcement, the 50bp hike in December now makes more sense.

It's well known that employment is a lagging indicator, but the Canadian labour market was racing ahead in the fourth quarter. With 104K jobs created in December and job openings still elevated, the labour market looks unfazed by the 400bps of rate hikes unleashed last year.

Overall economic growth did cool off in the fourth quarter of 2022, but the pace of increase will still surpass the central bank's October forecast by a wide margin. With all that in mind, it would be hard to argue that there was enough evidence to halt rate hikes just yet.

That doesn't mean that the Bank of Canada should keep ratcheting up rates until all these factors show progress. The lags inherent in monetary policy need to be respected. But a 25bp rate increase coupled with another vague suggestion that the Bank of Canada is open to pausing thereafter seems like the most probable course of action.

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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

UNITED STATES

MONDAY, January 23 - 10:30	
December	**m/m**
Consensus	-0.7%
Desjardins	-0.7%
November	**-1.0%**

Leading indicator (December) – The Conference Board's leading indicator was down for the eighth straight month in November, posting its worst monthly decline since March 2009 if you exclude the first wave of the pandemic. We anticipate yet another fall in December, with negative contributions coming from the ISM index, hours worked and consumer confidence in particular.

THURSDAY, January 26 - 8:30	
Q4 - 1st est.	**Ann. rate**
Consensus	2.9%
Desjardins	2.3%
Q3 - 3rd est.	**3.2%**

Real GDP (Q4 – first estimate) – A number of indicators suggest US real GDP will eventually contract, but it probably didn't in Q4. After expanding at an annualized rate of 3.2% in the third quarter, GDP likely advanced more than 2% in the fourth. Annualized growth in real consumption should come in at over 3%, boosted by another strong performance from the services sector. We should also see solid gains in business investment in equipment and intellectual property products. Expect falls in residential and non-residential construction, however. Unlike in the last two quarters, we anticipate a positive contribution from the change in business inventories.

THURSDAY, January 26 - 8:30	
December	**m/m**
Consensus	2.9%
Desjardins	1.6%
November	**-2.1%**

New durable goods orders (December) – New durable goods orders declined 2.1% in November, weighed down by a 30.4% plunge in aviation orders. Based on information from Boeing, the sector likely rebounded in December, though we'll probably see a drop in automotive orders. New orders excluding transportation were up a modest 0.1% in both October and November, but December is likely to be down based on lower readings for manufacturing output and the ISM Manufacturing Index. Excluding transportation, we're forecasting a decrease of 0.2%. Overall, we're anticipating 1.6% growth in new durable goods orders.

THURSDAY, January 26 - 10:00	
December	
Consensus	615,000
Desjardins	620,000
November	**640,000**

New home sales (December) – For the first time in 2022, we saw two straight months of growth in new single-family home sales in October and November. While it looks like they're starting to level off after spending most of the year in decline, they're still 38.3% below their cyclical peak, coming in at 640,000 in November. We anticipate a drop in December, although sales should remain above recent monthly lows. Building permits for single-family homes were down again in December, while mortgage applications for home purchases were up. We expect single-family home sales to dip from 640,000 to 620,000 units.

CANADA

WEDNESDAY, January 25 - 10:00	
January	
Consensus	4.50%
Desjardins	4.50%
November	**4.25%**

Bank of Canada rate decision (January) – The Bank of Canada is looking to hit the pause button soon, but central bankers won't be able to do so just yet. Given the ongoing strength in the economy and the stickiness of underlying inflationary pressures, look for monetary policymakers to nudge rates up another 25bps next week. That would take the policy rate up to a level matching the peak of the mid-2000s hiking cycle. But it takes time for rising rates to work their way through the economy, so the Bank of Canada will likely be cautious about signalling anything concrete regarding future decisions. Central bankers remain deeply data dependent, and upcoming readings on the economy will dictate the path forward.

TUESDAY, January 24 - 4:00

January	m/m
Consensus	n/a
December	**43.9%**

OVERSEAS

Eurozone: Purchasing Managers' Index (January – preliminary) – It looks like PMIs have stopped trending lower, at least for now. Although mostly under the 50 mark, they're hovering at around 49. The composite index for the eurozone even went up in the last two months of 2022. As we enter 2023, it remains to be seen whether PMIs will stay relatively stable or if they'll show us clearer signs of a drop-off in economic activity.

Economic Indicators

Week of January 23 to 27, 2023

Day	Time	Indicator	Period	Consensus	⬡	Previous data
UNITED STATES						
MONDAY 23	10:00	Leading indicator (m/m)	Dec.	-0.7%	-0.7%	-1.0%
TUESDAY 24	---	---				
WEDNESDAY 25	---	---				
THURSDAY 26	8:30	Initial unemployment claims	Jan. 16-20	n/a	212,000	190,000
	8:30	Real GDP – first estimate (ann. rate)	4Q	2.5%	2.3%	3.2%
	8:30	Durable goods orders (m/m)	Dec.	2.9%	1.6%	-2.1%
	8:30	Goods trade balance – preliminary (US$B)	Dec.	-88.8	-92.3	-83.3
	8:30	Retail inventories (m/m)	Dec.	n/a	n/a	0.1%
	8:30	Wholesale inventories – preliminary (m/m)	Dec.	0.5%	n/a	1.0%
	10:00	New home sales (ann. rate)	Dec.	615,000	620,000	640,000
FRIDAY 27	8:30	Personal income (m/m)	Dec.	0.2%	0.3%	0.4%
	8:30	Personal consumption expenditures (m/m)	Dec.	-0.1%	-0.1%	0.1%
	8:30	Personal consumption expenditures deflator				
		Total (m/m)	Dec.	0.0%	0.0%	0.1%
		Excluding food and energy (m/m)	Dec.	0.3%	0.2%	0.2%
		Total (y/y)	Dec.	5.0%	4.9%	5.5%
		Excluding food and energy (y/y)	Dec.	4.4%	4.4%	4.7%
	10:00	University of Michigan consumer sentiment index – final	Jan.	64.6	64.6	64.6
	10:00	Pending home sales (m/m)	Dec.	-1.0%	n/a	-4.0%
CANADA						
MONDAY 23	---	---				
TUESDAY 24	---	---				
WEDNESDAY 25	10:00	Bank of Canada meeting	Jan.	4.50%	4.50%	4.25%
	10:00	Release of the Bank of Canada Monetary Policy Report				
	11:00	Speech of Bank of Canada Governor T. Macklem				
THURSDAY 26	---	---				
FRIDAY 27	---	---				

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 - 5 hours). ⬡ Forecast of Desjardins, Economic Studies of the Desjardins Group.

Economic Indicators

Week of January 23 to 27, 2023

Country	Time	Indicator	Period	Consensus m/m (q/q)	Consensus y/y	Previous data m/m (q/q)	Previous data y/y
OVERSEAS							
MONDAY 23							
Euro zone	10:00	Consumer confidence – preliminary	Jan.	-20.0		-22.2	
Japan	19:30	PMI composite index – preliminary	Jan.	n/a		49.7	
Japan	19:30	PMI manufacturing index – preliminary	Jan.	n/a		48.9	
Japan	19:30	PMI services index – preliminary	Jan.	n/a		51.1	
TUESDAY 24							
Germany	2:00	Consumer confidence	Feb.	-33.0		-37.8	
France	2:45	Business confidence	Jan.	102		102	
France	2:45	Production outlook	Jan.	n/a		-7	
France	3:15	PMI composite index – preliminary	Jan.	49.5		49.1	
France	3:15	PMI manufacturing index – preliminary	Jan.	49.5		49.2	
France	3:15	PMI services index – preliminary	Jan.	49.7		49.5	
Germany	3:30	PMI composite index – preliminary	Jan.	49.6		49.0	
Germany	3:30	PMI manufacturing index – preliminary	Jan.	48.0		47.1	
Germany	3:30	PMI services index – preliminary	Jan.	49.5		49.2	
Euro zone	4:00	PMI composite index – preliminary	Jan.	49.8		49.3	
Euro zone	4:00	PMI manufacturing index – preliminary	Jan.	48.5		47.8	
Euro zone	4:00	PMI services index – preliminary	Jan.	50.2		49.8	
United Kingdom	4:30	PMI composite index – preliminary	Jan.	49.1		49.0	
United Kingdom	4:30	PMI manufacturing index – preliminary	Jan.	45.4		45.3	
United Kingdom	4:30	PMI services index – preliminary	Jan.	49.7		49.9	
WEDNESDAY 25							
Japan	00:00	Leading indicator – final	Nov.	n/a		97.6	
Japan	00:00	Coincident indicator – final	Nov.	n/a		99.1	
United Kingdom	2:00	Producer price index	Nov.	0.2%	16.4%	0.9%	17.2%
Germany	4:00	Ifo survey – business climate	Jan.	90.2		88.6	
Germany	4:00	Ifo survey – current situation	Jan.	95.0		94.4	
Germany	4:00	Ifo survey – expectations	Jan.	85.3		83.2	
THURSDAY 26							
Italy	4:00	Consumer confidence	Jan.	102.3		102.5	
Italy	4:00	Economic confidence	Jan.	n/a		107.8	
Japan	18:30	Consumer price index – Tokyo	Jan.		4.0%		4.0%
FRIDAY 27							
France	2:45	Consumer confidence	Jan.	n/a		82	
Euro zone	5:00	Money supply M3	Dec.		4.6%		4.8%

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 - 5 hours).