WEEKLY COMMENTARY

Is Everything under Control?

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

After seemingly mishandling financial conditions earlier this fall, Federal Reserve officials are now taking corrective steps. The "higher for longer" narrative dominated markets throughout the summer, and the FOMC meeting on September 20 offered an opportunity for Fed officials to stem the bond selloff. What they communicated at that meeting ended up having the opposite effect. In their forecast revisions, officials suggested they too were embracing the idea of higher-for-longer interest rates. What's striking is not just that the US 10-year yield increased by 45 basis points between the meeting and October 6, it's also that this increase was primarily driven by the term premium.

A longer-term interest rate can be broken down into the expected average level of overnight rates and a term premium that compensates for the risk of interest rate fluctuations. The latter component is a proxy for supply and demand conditions in bond markets. It had been in negative territory for almost eight years due to central banks' massive bond-buying programs. However, as global central banks are now reducing the size of their balance sheets, and as other previously faithful buyers of sovereign bonds are showing less appetite, the supply–demand dynamics have shifted, pushing the term premium higher. These shifts had been happening for some time. For instance, Chinese and Japanese holdings of US Treasurys had been declining at an accelerated clip since the pandemic. As a result, the term premium response was arguably long overdue.

The irony isn't lost on anyone that various Fed officials this week have been claiming to be monitoring financial conditions attentively while the published minutes of their September 20 meeting suggested the topic hadn't been particularly top of mind.

True, by conceding that the recent selloff obviated the need for further hikes, they have managed to dampen the rapid steepening of the yield curve. This allowed risk appetite to recover, though we think it will be temporary given that equities are still very expensive.

However, this episode could signal more volatility ahead. The Federal Reserve is grappling with the complexities of managing financial conditions in the late stages of a tightening cycle with a no-longer-dormant term premium. Not that the Fed doesn't have a solution if things were to escalate out of control. It could reactivate its bond-buying program in a heartbeat. But this of course would be the very last resort, as it would be very difficult to justify with sticky inflation and a tight labour market.

For now, the Fed is just in prevention mode and trying to softly nudge near-term interest rate hike expectations. The additional increase it was heralding has served as a convenient buffer. But if the bond selloff reaches levels that could only be countered with a decisively more dovish stance, communications will get more complicated. The fact that the selloff resumed after this week's stronger-than-expected September US CPI print tells us that the data might not allow for a convincing pivot for quite some time.

The risk would then be that damage caused by tighter financial conditions causes some casualties on the financial stability front. Last March's turbulence serves as a stark reminder. And ironically, the real economy fallout of that prior episode is now becoming more apparent. Bank lending is increasingly squeezed, the commercial real estate market is essentially frozen with defaults rising in the space, and the corporate world is grappling with crippling refinancing costs just as an estimated $5.5 trillion worth of corporate bonds is maturing next year globally. Meanwhile, concerns are rising over fiscal risks in places like Italy, whose bond ratings are just a notch above junk status. So the notion that central banks may have diminished influence over financial conditions should be a cause for concern at this juncture. This is especially true here in Canada, where term premium dynamics are primarily influenced by factors beyond our borders and are therefore disconnected from domestic interest rate-sensitivity considerations.

CONTENT

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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.

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

UNITED STATES

TUESDAY October 17 - 8:30

September	m/m
Consensus	0.3%
Desjardins	-0.1%
August	**0.6%**

Retail sales (September) – Retail sales had a relatively good August, growing 0.6%, although an increase in gasoline station receipts provided a big boost. We're anticipating more modest growth from that sector in September. We also expect to see an increase in the automotive sector, based on the rise in new motor vehicle sales published earlier this month. Preliminary card transaction data suggests we're likely to see a decline in sales for other components, however. The biggest detractors should be food services and durable goods categories (furniture, electronics, building materials stores). All in all, we expect a 0.1% drop in retail sales and a 0.3% decrease in sales excluding motor vehicles and gasoline.

TUESDAY October 17 - 9:15

September	m/m
Consensus	0.0%
Desjardins	0.0%
August	**0.4%**

Industrial production (September) – After adding 0.7% in July, industrial production grew 0.4% in August despite a notable decline in the automotive sector, which is likely to have contracted further in September. Hours worked suggest an increase, but the labour force survey was conducted before plant workers at the Big Three US automakers went on strike. The labour dispute should have more of an impact on industrial production data, dragging down the entire manufacturing sector, even with a 0.2% gain predicted for its non-automotive components. We expect to see upticks of around 0.5% in the mining and energy production sectors, no change in industrial production (0.0%) and a 0.2% decline in manufacturing.

WEDNESDAY October 18 - 8:30

September	ann. rate
Consensus	1,380,000
Desjardins	1,400,000
August	**1,283,000**

Housing starts (September) – Housing starts plummeted in August, sinking 11.3% month-over-month to an annualized rate of 1,283,000 units, the lowest level since July 2019 excluding the first few months of the pandemic. The decline is partly attributable to Hurricane Hilary, which hit California, helping send housing starts in the western US down some 30%. We expect things to have picked up in the region in September. Building permits continued to rise in August and 6,700 residential construction jobs were added in September, two positive signs for the month's housing starts. But between a slowdown in new single-family home sales and rising mortgage rates, the next few months could prove more challenging.

THURSDAY October 19 - 10:00

September	ann. rate
Consensus	3,880,000
Desjardins	3,850,000
August	**4,040,000**

Existing home sales (September) – Existing home sales fell 2.2% in August, marking a second consecutive monthly decline and bringing them to their lowest level since January. We expect them to have fallen further in September. Rising mortgage rates over the summer had a big impact on loan applications, affecting pending home sales, too. Preliminary regional data also suggests existing home sales declined in September. We expect them to come in at under 3,900,000 units.

THURSDAY October 19 - 10:00

September	m/m
Consensus	-0.4%
Desjardins	-0.5%
August	**-0.4%**

Leading indicator (September) – The leading indicator continues to point to an imminent slowdown of the US economy, although the signal has become less clear than it was at the start of the year. Even so, we're anticipating a bigger decline for September than what we saw in July (-0.2%) and August (-0.4%). With negative contributions from household confidence, building permits, the ISM index and the interest rate differential, we expect the leading indicator to have fallen 0.5% in September.

CANADA

MONDAY October 16 - 8:30

August	m/m
Consensus	n/a
Desjardins	1.9%
July	**1.6%**

Manufacturing sales (August) – Manufacturing sales are expected to have increased 1.9% in Canada in August, for a second consecutive month of growth. This gain is likely to have been underpinned by advances in both prices and volumes. The forecast increase in prices was probably largely driven by the rise in the cost of energy and petroleum products. On the volumes side, exports of motor vehicle engines and parts rose in August as did auto production, pointing to higher auto manufacturing sales. Our projected 1.9% increase in factory sales is much higher than Statistics Canada's 1.0% flash estimate.

TUESDAY October 17 - 8:15

September	ann. rate
Consensus	n/a
Desjardins	240,000
August	**252,800**

Housing starts (September) – We continue to anticipate that housing starts will slow and expect the data for September to reveal just 240k units last month. Existing home sales are now clearly trending lower, as are national-level employment in the construction industry and building permits. And of course builders have long been struggling with labour shortages, elevated input costs and sharply higher interest rates. As always, we'll be watching for regional differences: homebuilding has so far weakened much more significantly in Quebec and Alberta than in Ontario and BC. Resilience to date in the latter two regions has prevented national-level starts from coming down more meaningfully.

TUESDAY October 17 - 8:30

September	m/m
Consensus	n/a
Desjardins	0.1%
August	**0.4%**

Consumer Price Index (September) – The annual rate of headline inflation likely remained unchanged in September at 4.0%. That still remains much higher than the 2.8% seen earlier this year. Energy prices were a touch weaker on the month and should put some downward pressure on the headline number following a large increase in August. Excluding the more volatile food and energy components, we could see more progress towards taming inflation with the annual rate of core inflation expected to have decelerated a few ticks in September. The 3.5% ex-food and energy inflation reading we are forecasting would be the slowest pace of growth since November 2021. That said, it will be important for any such disinflation to also show up in the two Bank of Canada core measures. Unfortunately, the three-month annualized rates of those indicators are expected to remain sticky in the 4.0% to 4.5% range.

FRIDAY October 20 - 8:30

August	m/m
Consensus	n/a
Desjardins	0.5%
July	**0.3%**

Retail sales (August) – Retail sales likely increased in August for the fifth consecutive month. Our forecast calls for a 0.5% advance, higher than Statistics Canada's flash estimate of -0.3%. Stronger auto sales probably brought up the headline in August. As such, we expect the core retail sales print to be weaker. We think the headline number will be supported by prices as gasoline and core goods inflation were up in August. Once again, we're forecasting Statistics Canada's flash estimate for September to show growth picking up with auto sales still climbing during the month.

OVERSEAS

TUESDAY October 17 - 22:00

Q3	y/y
Consensus	4.5%
Q2	**6.3%**

China: Real GDP (third quarter) – While the post-pandemic rebound propelled q/q real GDP growth to 2.2% in the first quarter, the momentum quickly faded, limiting the second quarter's gains to just 0.8%. The lacklustre performance can be attributed to the impacts of a stagnant housing market and a weak rebound in consumer spending, two major drivers of China's growth. The picture is less clear for the third quarter, with purchasing managers' indexes showing a gradual recovery and exports taking a big hit. But with the government having ramped up support measures, we expect to see improved real GDP growth for the quarter.

Economic Indicators

Week of October 16 to 20, 2023

Date	Time	Indicator	Period	Consensus	Desjardins	Previous reading
UNITED STATES						
MONDAY 16	8:30	Empire State Manufacturing Index	Oct.	-5.5	-10.0	1.9
	10:30	Speech by Federal Reserve Bank of Philadelphia President P. Harker				
TUESDAY 17	8:00	Speech by Federal Reserve Bank of New York President J. Williams				
	8:30	Retail sales				
		Total (m/m)	Sept.	0.3%	-0.1%	0.6%
		Excluding automobiles (m/m)	Sept.	0.2%	-0.3%	0.6%
	9:15	Industrial production (m/m)	Sept.	0.0%	0.0%	0.4%
	9:15	Production capacity utilization rate	Sept.	79.6%	79.6%	79.7%
	10:00	NAHB housing market index	Oct.	44	n/a	45
	10:00	Business inventories (m/m)	Aug.	0.3%	0.4%	0.0%
	10:45	Speech by Federal Reserve Bank of Richmond President T. Barkin				
WEDNESDAY 18	8:30	Housing starts (ann. rate)	Sept.	1,380,000	1,400,000	1,283,000
	8:30	Building permits (ann. rate)	Sept.	1,450,000	1,450,000	1,541,000
	14:00	Release of the Beige Book				
THURSDAY 19	8:30	Initial unemployment claims	Oct. 9–13	214,000	212,000	209,000
	8:30	Philadelphia Fed index	Oct.	-6.0	-10.0	-13.5
	10:00	Existing home sales (ann. rate)	Sept.	3,880,000	3,850,000	4,040,000
	10:00	Leading indicator (m/m)	Sept.	-0.4%	-0.5%	-0.4%
	12:00	Speech by Federal Reserve Chair J. Powell				
	19:00	Speech by Federal Reserve Bank of Dallas President L. Logan				
FRIDAY 20	9:00	Speech by Federal Reserve Bank of Philadelphia President P. Harker				
CANADA						
MONDAY 16	8:30	Manufacturing sales (m/m)	Aug.	n/a	1.9%	1.6%
	8:30	Wholesale sales	Aug.	n/a	2.6%	n/a
	10:30	Release of the Bank of Canada's Business Outlook Survey				
TUESDAY 17	8:15	Housing starts (ann. rate)	Sept.	n/a	240,000	252,800
	8:30	Consumer price index				
		Total (m/m)	Sept.	n/a	0.1%	0.4%
		Total (y/y)	Sept.	n/a	4.0%	4.0%
WEDNESDAY 18	---	---				
THURSDAY 19	8:30	Raw materials price index (m/m)	Sept.	n/a	0.9%	3.0%
	8:30	Industrial product price index (m/m)	Sept.	n/a	0.3%	1.3%
FRIDAY 20	8:30	Retail sales				
		Total (m/m)	Aug.	n/a	0.5%	0.3%
		Excluding automobiles (m/m)	Aug.	n/a	0.4%	1.0%

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 October 16 to 20, 2023

Country	Time	Indicator	Period	Consensus m/m (q/q)	Consensus y/y	Previous reading m/m (q/q)	Previous reading y/y
OVERSEAS							
MONDAY 16							
Japan	0:30	Industrial production – final	Aug.	n/a	n/a	0.0%	-3.8%
Eurozone	5:00	Trade balance (€B)	Aug.	n/a		2.9	
TUESDAY 17							
Japan	0:30	Tertiary Industry Activity Index		0.3%		0.9%	
United Kingdom	2:00	ILO unemployment rate	Aug.	4.3%		4.3%	
Germany	5:00	ZEW Current Conditions Survey	Oct.	-80.5		-79.4	
Germany	5:00	ZEW Expectations Survey	Oct.	-9.0		-11.4	
China	22:00	Real GDP	Q3	1.0%	4.5%	0.8%	6.3%
China	22:00	Industrial production	Sept.		4.3%		4.5%
China	22:00	Retail sales	Sept.		4.9%		4.6%
WEDNESDAY 18							
South Korea	---	Bank of Korea meeting	Oct.	3.50%		3.50%	
Japan	0:30	Trade balance (¥B)	Sept.	-500.4		-555.7	
United Kingdom	2:00	Consumer price index	Sept.	0.4%	6.5%	0.3%	6.7%
United Kingdom	2:00	Producer price index	Sept.	0.3%	-0.2%	0.2%	-0.4%
Italy	4:00	Trade balance (€M)	Aug.	n/a		6,375	
Eurozone	5:00	Construction		n/a	n/a	0.8%	1.0%
Eurozone	5:00	Consumer price index – final	Sept.	0.3%	4.3%	0.3%	5.3%
THURSDAY 19							
France	2:45	Business confidence	Oct.	99		100	
France	2:45	Production outlook	Oct.	-8		-6	
Eurozone	4:00	Current account (€B)	Aug.	n/a		20.9	
Italy	4:30	Current account (€M)	Aug.	n/a		5,156	
United Kingdom	19:01	Consumer confidence	Oct.	-20		-21	
Japan	19:30	Consumer price index	Sept.		3.0%		3.2%
FRIDAY 20							
Germany	2:00	Producer price index	Sept.	0.4%	-14.2%	0.3%	-12.6%
United Kingdom	2:00	Retail sales	Sept.	-0.4%	-0.1%	0.4%	-1.4%
France	2:45	Retail sales	Oct.		n/a		-4.0%

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).