WEEKLY COMMENTARY

Bank of Canada Preview: Full Steam Ahead

By Royce Mendes, Managing Director and Head of Macro Strategy

Earlier this year, we wrote that the Bank of Canada was in a race against time to lower interest rates ahead of the mortgage renewal wall. The further cooling of inflationary pressures and rise in the unemployment rate means that central bankers need to continue cutting rates at each of their fixed announcement dates at least until the policy rate returns to a more neutral range. While that won't guarantee a soft landing with population growth set to slow, lenders tightening credit conditions and trade wars heating back up, it offers the best shot at avoiding unnecessary pain from mortgage renewals.

The Bank of Canada's forecast for the economy looks too optimistic. In the July Monetary Policy Report, central bankers had projected a sharp rebound in economic activity in Q3, but early indications point to a more subdued pace of increase. Rate cuts aren't providing much stimulus to the housing market yet. This comes as little surprise to us. The combination of still-high house prices and mortgage rates means that home ownership remains out of reach for many. Upsizing has also been restrained by those same forces. Falling interest rates haven't spurred an acceleration in consumer spending either. So far, households remain cautious, with many set to face higher mortgage or rent payments.

As rates fall further, we do expect Canadians to become less tightfisted. Outside of the pandemic, the household savings rate of 7.2% in the second quarter was the highest since 1996. That leaves a buffer for some Canadians to make higher mortgage or rent payments out of their monthly incomes. Moreover, many households still have significant sums of cash saved in their bank accounts. That money has been earning high interest. To unlock that cash and avoid a recession, the question is: How rapidly does the Bank of Canada need to ease policy? As of right now, we see 25 bp rate cuts at each of the central bank's next six decision dates, followed by a brief pause and then a continuation down to a trough of 2.25% by the end of 2025. While that was previously seen as a very dovish forecast, the risk now is that rates fall faster to that terminal level.

Overnight indexed swaps are pricing in only a very small probability that policymakers will need to reduce rates by 50 bps in October. Given that inflation has been all but tamed, we think there's actually a somewhat more material chance that a 50-bp rate cut will be required before the end of the year. Standard 25-bp reductions are still our base case forecast, but we can't ignore how much the discourse surrounding the economy and inflation have changed. Central bankers around the world are now more focused on stemming the deterioration in labour markets than they are on the last mile of the inflation fight.

The July monetary policy statement contended that officials were balancing the upside risks to inflation with the downside risks to the economy. The September communiqué should place more emphasis on the latter. The labour market has continued to deteriorate with stagnant hiring and still-rapid population growth leading to a rising unemployment rate.

The danger now is that the Bank of Canada falls behind the curve if policymakers remain too focused on the slightly above-target inflation. Following previous tightening cycles, central banks have often responded too late to signs of economic deterioration. Achieving a soft landing in this cycle is an even taller order given Canada's vulnerabilities and the headwinds it will be facing in

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quarters ahead. Policymakers will need to be alert and nimble to avoid repeating mistakes of the past.

We believe central bankers are attuned to the changing dynamics and will sound more dovish next week. As a result, we see some room for rate cut expectations to build both for the near-term and further out. The implied probability of a 50-bp cut in October should increase and the policy rate expected by the end of 2025 should fall from the current 2.75% closer to our long-held forecast of 2.25%. In short, we see more expeditious policy easing than the market is currently incorporating over that time horizon. The higher-for-longer narrative is dead and it’s full steam ahead for rate cuts.

What to Watch For

UNITED STATES

TUESDAY September 3 - 10:00

August	
Consensus	47.5
Desjardins	45.5
July	**46.8**

ISM Manufacturing index (August) – In July, the ISM Manufacturing index fell to its lowest level since November 2023. Several components—including production and new orders—declined, but the steepest drop was in employment, which plummeted 5.9 points. That brought this component down to a level unseen since spring 2009, if we don't count the first few months of the pandemic. The regional manufacturing index readings published so far for August aren't pointing to a recovery in the ISM Manufacturing index, but rather a slight drop.

THURSDAY September 5 - 10:00

August	
Consensus	50.9
Desjardins	52.0
July	**51.4**

ISM Services index (August) – After falling below 50 in June (for the second time in 3 months), the ISM Services index recovered to 51.4 but remained weak. Regional non-manufacturing indexes are somewhat mixed and consumer confidence indexes have improved, so the ISM Services index likely edged up in August.

FRIDAY September 6 - 8:30

August	
Consensus	155,000
Desjardins	170,000
July	**114,000**

Change in nonfarm payrolls (August) – July's employment numbers got people talking, with many viewing them as a sign of an imminent recession. The 114,000 jobs added last month does indeed seem low compared to the consensus and previous prints. The rise in the unemployment rate to 4.3% was also cause for concern. However, labour market weakness was probably exaggerated in July and exacerbated by Hurricane Beryl. In the wake of the storm, the number of absences from work due to bad weather rose to an unprecedented level for July. The number of people on temporary layoff also surged. We expect to see these situations reverse, potentially in August unless Hurricane Debby clouded the data once more. Hiring is expected to have increased slightly, while the unemployment rate likely edged down.

CANADA

WEDNESDAY September 4 - 8:30

July	**$B**
Consensus	n/a
Desjardins	2.5
June	**0.6**

International trade (July) – Canada's trade surplus is expected to have widened in July. Exports likely continued trending upward as the new TMX pipeline should have supported elevated energy exports like it did in June. However, the wildfires in Alberta may have disrupted the flow of oil products. At the same time, Canadian auto production was relatively flat in July while US light vehicle assemblies declined by 11.3%, which could weigh on total exports. In contrast to exports, we expect the Canadian import print to be relatively flat in July. Indeed, the US advance trade data showed a notable decrease in exports of motor vehicles and parts. Moreover, high volatility in some trade categories, like precious metals, as well as the disruptions caused by Hurricane Beryl and the cyberattack on US car dealerships could have unknown repercussions on the trade balance.

WEDNESDAY September 4 - 9:45

September	
Consensus	4.25%
Desjardins	4.25%
July 24	**4.50%**

Bank of Canada meeting (September) – There's little question about whether policymakers will lower rates by 25 bps next week. However, with the economy clearly slowing and inflation largely under control, central bankers might opt for a more dovish message. The communiqué could place more emphasis on the need to stem the slowdown in the labour market instead of focusing on the last mile of the inflation fight . At the least, this would solidify expectations that the Bank of Canada will be moving its policy rate lower at each of its next few meetings. It could also open the door to a discussion about whether central bankers need to move faster, perhaps with a 50-bp rate cut at one of its upcoming decisions. With no accompanying Monetary Policy Report, all the attention will be on the wording of the statement and Governor Macklem's tone at the press conference.

THURSDAY September 5 - 8:30	
Q2 2024	**q/q**
Consensus	-0.1%
Desjardins	0.2%
Q1 2024	**-0.3%**

Labour productivity (Q2) – We anticipate that labour productivity growth came in at a 0.2% q/q pace in the second quarter of 2024, following a contraction of 0.3% in the first quarter. This expected improvement likely reflected a slower pace of growth in total actual hours worked in the business sector in the second quarter—another sign of a cooling labour market. Furthermore, business sector real GDP growth remained positive at 0.5%. That said, as the impacts of high interest rates continue to dampen economic activity, we expect labour productivity to decline in the near term, only improving if population growth slows.

FRIDAY September 6 - 8:30	
August	
Consensus	25,000
Desjardins	30,000
July	**-2,800**

Net change in employment (August) – The Canadian economy has been in an environment of no hiring and no firing for the past couple of months. While we do expect a rebound in job growth, it’s likely to come alongside further increases in population and a recovery in labour force participation. As a result, despite the resumption of hiring in August, we expect the unemployment rate to jump two ticks to 6.6%. Such a move will ignite debate about whether the Bank of Canada needs to cut rates by 50 bps in October. The central bank is now more focused on the labour market since inflation has largely been tamed.

Economic Indicators

Week of September 2 to 6, 2024

Date	Time	Indicator	Period	Consensus	Desjardins forecast	Previous reading
UNITED STATES						
MONDAY 2	---	Markets closed (Labor Day)				
TUESDAY 3	10:00	Construction spending (m/m)	July	0.1%	-0.4%	-0.3%
	10:00	ISM Manufacturing index	August	47.5	46.5	46.8
WEDNESDAY 4	8:30	Trade balance – goods and services (US$B)	July	-78.9	-79.4	-73.1
	10:00	Factory orders (m/m)	July	4.7%	5.5%	-3.3%
	14:00	Release of the Beige Book				
	---	Total vehicle sales (ann. rate)	August	15,400,000	15,200,000	15,820,000
THURSDAY 5	8:30	Initial unemployment claims	August 26–30	228,000	228,000	231,000
	8:30	Nonfarm productivity – final (ann. rate)	Q2	2.5%	2.5%	2.3%
	8:30	Unit labor costs – final (ann. rate)	Q2	0.8%	0.7%	0.9%
	10:00	ISM Services index	August	50.9	52.0	51.4
FRIDAY 6	8:30	Change in nonfarm payrolls	August	155,000	170,000	114,000
	8:30	Unemployment rate	August	4.2%	4.2%	4.3%
	8:30	Average weekly hours	August	34.3	34.3	34.2
	8:30	Average hourly earnings (m/m)	August	0.3%	0.2%	0.2%
	8:45	Speech by Federal Reserve Bank of New York President J. Williams				
	11:00	Speech by Federal Reserve Governor C. Waller				
CANADA						
MONDAY 2	---	Markets closed (Labour Day)				
TUESDAY 3	---	---				
WEDNESDAY 4	8:30	International trade ($B)	July	n/a	2.50	0.64
	9:45	Bank of Canada meeting	September	4.25%	4.25%	4.50%
	10:30	Speech by Bank of Canada Governor T. Macklem and Senior Deputy Governor C. Rogers				
THURSDAY 5	8:30	Labour productivity (q/q)	Q2	-0.1%	0.2%	-0.3%
FRIDAY 6	8:30	Net change in employment	August	25,000	30,000	-2,800
	8:30	Unemployment rate	August	6.5%	6.6%	6.4%

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 2 to 6, 2024

Country	Time	Indicator	Period	Consensus m/m (q/q)	Consensus y/y	Previous reading m/m (q/q)	Previous reading y/y
OVERSEAS							
DURING THE WEEK							
Germany	---	Retail sales	May	0.1%	-0.7%	-0.2%	2.9%
SUNDAY 1							
Japan	20:30	Manufacturing PMI – final	August	n/a		49.5	
MONDAY 2							
Italy	3:45	Manufacturing PMI	August	47.9		47.4	
France	3:50	Manufacturing PMI – final	August	42.1		42.1	
Germany	3:55	Manufacturing PMI – final	August	42.1		42.1	
Eurozone	4:00	Manufacturing PMI – final	August	45.6		45.6	
Italy	4:00	Real GDP – final	Q2	0.2%	0.9%	0.2%	0.9%
United Kingdom	4:30	Manufacturing PMI – final	August	52.5		52.5	
TUESDAY 3							
Japan	20:30	Composite PMI – final	August	n/a		53.0	
Japan	20:30	Services PMI – final	August	n/a		54.0	
WEDNESDAY 4							
Italy	3:45	Composite PMI	August	n/a		50.3	
Italy	3:45	Services PMI	August	52.5		51.7	
France	3:50	Composite PMI – final	August	52.7		52.7	
France	3:50	Services PMI – final	August	55.0		55.0	
Germany	3:55	Composite PMI – final	August	48.5		48.5	
Germany	3:55	Services PMI – final	August	51.4		51.4	
Eurozone	4:00	Composite PMI – final	August	52.2		51.2	
Eurozone	4:00	Services PMI – final	August	53.3		53.3	
United Kingdom	4:30	Composite PMI – final	August	53.4		53.4	
United Kingdom	4:30	Services PMI – final	August	53.3		53.3	
Eurozone	5:00	Producer price index	July	0.3%	-2.5%	0.5%	-3.2%
THURSDAY 5							
Germany	2:00	Factory orders	July	-1.5%	-1.9%	3.9%	-11.8%
Eurozone	5:00	Retail sales	July	0.2%	0.2%	-0.3%	-0.3%
FRIDAY 6							
Germany	2:00	Trade balance (€B)	July	20.8		20.4	
Germany	2:00	Industrial production	July	-0.4%	-3.5%	1.4%	-4.1%
France	2:45	Trade balance (€M)	July	n/a		6,088	
France	2:45	Current account (€B)	July	n/a		-2.6	
France	2:45	Industrial production	July	-0.3%	-0.8%	0.8%	-1.6%
Italy	4:00	Retail sales	July	n/a	n/a	-0.2%	-1.0%
Eurozone	5:00	Net change in employment – final	Q2	n/a	n/a	0.2%	0.8%
Eurozone	5:00	Real GDP – final	Q2	0.3%	0.6%	0.3%	0.6%

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).