WEEKLY COMMENTARY

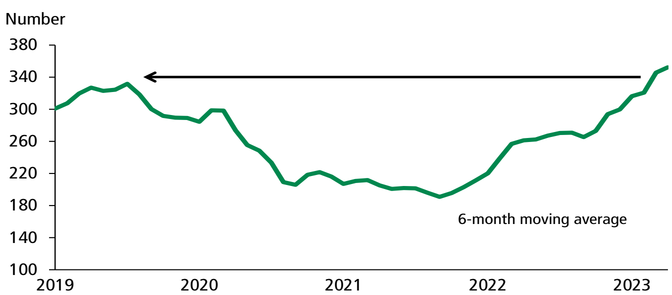
Canadian Businesses Are Struggling, Sending Insolvencies Higher

By Hélène Bégin, Principal Economist

It's been a tough three years for businesses. Early in the pandemic, some endured rounds of closures that slashed their income and drove up their debt. But the days of government support and relief from financial institutions are long gone. Businesses now face a harsh reality: costs are way up, and higher interest rates are making it harder to pay off debt.

For the most vulnerable sectors that barely made it out of the pandemic, elevated interest rates could be the straw that breaks the camel's back. It's no surprise then that business insolvencies are spiking, already exceeding 2019 levels (graph). According to the Office of the Superintendent of Bankruptcy, between April 2022 and April 2023, insolvencies were up 33.3% in Canada, 26.8% in Ontario and 31.0% in Quebec.

GRAPH
Canada: Business Insolvencies Are Back above Pre-pandemic Levels



Sources: Office of the Superintendent of Bankruptcy Canada and Desjardins Economic Studies

National data shows that retail and wholesale trade have been hardest hit, with insolvencies over the past year up 109.5% and 66.7% respectively. While global supply chains and container shipping rates are back to normal, other obstacles remain and new challenges have emerged. Inflation is still relatively high in Canada, though it currently stands at 4.4%, down considerably from last summer's 8.1% peak. Year-over-year hourly wage growth also remains strong, at more than 5% nationally. And since businesses depend on workers, higher wages continue to eat into profits.

What's more, many retailers and wholesalers now have large inventories that are driving up storage costs. Until last year, inventory levels were unusually low due to supply chain issues. Now it's the opposite. The same is true of interest rates, which were at record low levels during the pandemic, making it easy to get a loan. Now interest rates are high, making it harder to pay off debt and increasing the risk of insolvency.

Insolvencies are also on the rise in the accommodation and food services sector, which saw a year-over-year increase of 32.5% in April. The sector trails only wholesale and retail trade for insolvencies. It's an especially challenging time for restaurant owners, who are contending with nearly 10% food inflation. Even though they've raised their prices, many restaurants have had to cut their profit margins as well. A worker shortage, high turnover and soaring wages have brought many eating establishments to the brink. Highly leveraged restaurants already battered by the pandemic may not be able to weather today's high interest rates. Meanwhile hotels are seeing higher occupancy rates thanks to more leisure travel and convention bookings, but some are shouldering a growing debt burden.

In short, consumer-focused sectors—which have yet to fully recover from the pandemic—are facing new cost challenges. To make matters worse, many businesses are still dealing with severe labour shortages. Businesses—especially small businesses—can't take on much more debt, and their income is particularly sensitive to household discretionary spending. But households are also making tough decisions right now to manage their budget in today's high inflation, high interest rate environment. The next few quarters could be very painful for some sectors if consumer spending slows as expected.

CONTENT

Desjardins Economic Studies: 514-281-2336 or 1-866-866-7000, ext. 5552336 • desjardins.economics@desjardins.com • desjardins.com/economics

In the meantime, the labour market could cool significantly as many businesses—especially those in labour-intensive sectors—see their finances deteriorate. Over the past year, one-third of insolvencies in Canada were in retail, wholesale, and accommodation and food services. These three sectors currently account for about 20% of the workforce nationwide. If the labour market softens as expected, it could be because businesses can't afford to hire or retain workers anymore. The Canadian economy has been resilient so far, but it's very vulnerable on this front. As business insolvencies continue to climb, more people will be looking for work. It remains to be seen whether businesses on a stronger financial footing will be able to hire them all.

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

UNITED STATES

TUESDAY, June 20 - 8:30

May	
Consensus	1,395,000
Desjardins	1,390,000
April	**1,401,000**

Housing starts (May) – Housing starts have been volatile all year, with February's 7.2% spike followed by a 4.3% drop in March and a 2.2% gain in April. We think this volatility will continue with a modest decline in May. Building permits issued have dropped 4.4% over the last two months, while employment in residential building construction edged up in May. We think housing starts will come in at 1,390,000 units.

THURSDAY, June 22 - 10:00

May	
Consensus	4,250,000
Desjardins	4,280,000
April	**4,280,000**

Existing home sales (May) – After surging 13.8% in February, existing home sales fell 2.6% in March and 3.4% in April. Based on stable pending home sales, we expect May's print to be largely unchanged. Looking at the preliminary regional data for existing home sales, a negative year-over-year change suggests a virtually flat month. That said, further increases in mortgage rates and fewer mortgage applications pose a downside risk.

THURSDAY, June 22 - 10:00

May	**m/m**
Consensus	-0.1%
Desjardins	-0.8%
April	**-0.6%**

Leading indicator (May) – The leading indicator fell for the thirteenth straight month in April and has now dropped 8.7% from its December 2021 cyclical peak, a clear sign that US economic activity is contracting. This downward trend is expected to continue in May, as the positive impacts of the stock market and unemployment claims won't fully offset the headwinds from the ISM index, consumer confidence and interest rate spreads. We think the leading indicator will fall by 0.8%.

CANADA

WEDNESDAY, June 21 - 8:30

April	**m/m**
Consensus	0.3%
Desjardins	0.7%
March	**-1.4%**

Retail trade (April) – After two consecutive months of decline, retail sales likely bounced higher in April. We forecast a 0.7% rise in sales, which is stronger than Statistics Canada's 0.2% flash estimate. Higher gas prices and a rebound in auto sales likely drove this increase. As a result, the print will probably look weaker excluding autos and gas. Core retail sales are expected to have advanced just 0.2%, which is more in line with the recent trend in that series. Overall, retail sales appear to be moderating even though population growth remains strong.

OVERSEAS

THURSDAY, June 22 - 2:00

June	
Consensus	4.75%
Desjardins	4.75%
May 11	**4.50%**

United Kingdom: Bank of England meeting (June) – Among the major advanced economies, inflation is of greatest concern in the United Kingdom. The three-month annualized change in inflation excluding food and energy is close to 12%. At the same time, the economy remains resilient. While growth isn't strong, we also don't see a lot of recession-worthy data that would allow inflation to cool quickly in the coming quarters. The Bank of England will almost certainly announce another rate hike next week. The consensus is for a 25-basis point increase, but a more aggressive 50 basis points would make sense too. Either way, the BoE will likely telegraph that its inflation fight is far from over. May's consumer price index will be released on June 21, the day before the central bank meets.

THURSDAY, June 22 - 19:30

May	**y/y**
Consensus	3.2%
April	**3.5%**

Japan: Consumer Price Index (May) – Long held up as an example of a country where deflation had taken a dangerous hold, Japan is experiencing a rare inflation spike. Admittedly, April's 3.5% headline inflation rate is lower than January's 4.4% peak. Like in the rest of the world, the recent slowdown is mostly due to cheaper energy prices than last year. Stripping out that effect, inflation continues to rise, as shown by the all items less food and energy index, which reached 4.1% in April, its highest level since late summer 1981. It'll be interesting to see whether inflation continues to rise in Japan.

FRIDAY, June 23 - 4:00	
June	
Consensus	52.5
May	**52.8**

Eurozone: PMI (June – preliminary) – The eurozone composite PMI's recent rise seems to have ended in April. The index fell in May from 54.1 to 52.8, with manufacturing and services both down. The manufacturing PMI dropped further below 50, signalling a sector contraction. Meanwhile, the services PMI fell back from its recent peaks, which proved difficult to sustain amid rising interest rates, tighter credit conditions, weak confidence and widespread uncertainty. A further decline in June would be consistent with a European economy that's still struggling.

Economic Indicators

Week of June 19 to 23, 2023

Day	Time	Indicator	Period	Consensus	Desjardins forecast	Previous reading
UNITED STATES						
MONDAY 19	---	---				
TUESDAY 20	6:30	Speech by Federal Reserve Bank of St. Louis President J. Bullard				
	8:30	Housing starts (ann. rate)	May	1,395,000	1,390,000	1,401,000
	8:30	Building permits (ann. rate)	May	1,423,000	1,400,000	1,417,000
	11:45	Speech by Federal Reserve Bank of New York President J. Williams				
WEDNESDAY 21	10:00	Testimony of Federal Reserve Chair J. Powell before a House committee				
	12:25	Speech by Federal Reserve Bank of Chicago President A. Goolsbee				
THURSDAY 22	4:00	Speech by Federal Reserve Governor C. Waller				
	8:30	Initial unemployment claims	June 12–16	260,000	259,000	262,000
	8:30	Current account (US$B)	Q1	-218.2	-215.0	-206.8
	9:55	Speech by Federal Reserve Governor M. Bowman				
	10:00	Leading indicator (m/m)	May	-0.8%	-0.8%	-0.6%
	10:00	Existing home sales (ann. rate)	May	4,250,000	4,280,000	4,280,000
	10:00	Testimony of Federal Reserve Chair J. Powell before a Senate committee				
	10:00	Speech by Federal Reserve Bank of Cleveland President L. Mester				
	16:30	Speech by Federal Reserve Bank of Richmond President T. Barkin				
FRIDAY 23	5:15	Speech by Federal Reserve Bank of St. Louis President J. Bullard				
	13:40	Speech by Federal Reserve Bank of Cleveland President L. Mester				
CANADA						
MONDAY 19	8:30	Industrial product price index (m/m)	May	n/a	-0.8%	-0.2%
	8:30	Raw materials price index (m/m)	May	n/a	-4.3%	2.9%
TUESDAY 20	---	---				
WEDNESDAY 21	8:30	Retail sales				
		Total (m/m)	April	0.3%	0.7%	-1.4%
		Excluding automobiles (m/m)	April	0.3%	0.7%	-0.3%
	13:30	Release of the Bank of Canada Summary of Deliberations				
THURSDAY 22	---	---				
FRIDAY 23	---	---				

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 19 to 23, 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 19							
---	---						
TUESDAY 20							
Japan	00:30	Industrial production – final	April	n/a	n/a	-0.4%	-0.3%
Germany	2:00	Producer price index	May	-0.7%	1.7%	0.3%	4.1%
Eurozone	4:00	Current account (€B)	April	n/a		31.2	
Italy	4:30	Current account (€M)	April	n/a		3,713	
Eurozone	5:00	Construction	April	n/a	n/a	-1.6%	-2.4%
WEDNESDAY 21							
United Kingdom	2:00	Consumer price index	May	0.5%	8.4%	1.2%	8.7%
United Kingdom	2:00	Producer price index	May	-0.1%	3.4%	0.0%	5.4%
Brazil	17:30	Central Bank of Brazil meeting	June	13.75%		13.75%	
THURSDAY 22							
France	2:45	Business confidence	June	100		100	
Switzerland	3:30	Swiss National Bank meeting	June	1.75%		1.50%	
Norway	4:00	Bank of Norway meeting	June	3.50%		3.25%	
United Kingdom	7:00	Bank of England meeting	June	4.75%		4.50%	
Mexico	15:00	Bank of Mexico meeting	June	11.25%		11.25%	
Eurozone	10:00	Consumer confidence – preliminary	June	-17.0		-17.4	
United Kingdom	19:01	Consumer confidence	June	-25		-27	
Japan	19:30	Consumer price index	May		3.2%		3.5%
Japan	20:30	Composite PMI – preliminary	June	n/a		54.3	
Japan	20:30	Manufacturing PMI – preliminary	June	n/a		50.6	
Japan	20:30	Services PMI – preliminary	June	n/a		55.9	
FRIDAY 23							
United Kingdom	2:00	Retail sales	May	-0.2%	-2.6%	0.5%	-3.0%
France	3:15	Composite PMI – preliminary	June	50.9		51.2	
France	3:15	Manufacturing PMI – preliminary	June	45.3		45.7	
France	3:15	Services PMI – preliminary	June	52.2		52.5	
Germany	3:30	Composite PMI – preliminary	June	53.4		53.9	
Germany	3:30	Manufacturing PMI – preliminary	June	43.5		43.2	
Germany	3:30	Services PMI – preliminary	June	56.2		57.2	
Eurozone	4:00	Composite PMI – preliminary	June	52.5		52.8	
Eurozone	4:00	Manufacturing PMI – preliminary	June	44.8		44.8	
Eurozone	4:00	Services PMI – preliminary	June	54.4		55.1	
United Kingdom	4:30	Composite PMI – preliminary	June	53.6		54.0	
United Kingdom	4:30	Manufacturing PMI – preliminary	June	46.8		47.1	
United Kingdom	4:30	Services PMI – preliminary	June	54.8		55.2	

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).