WEEKLY COMMENTARY

Can Canada Remain "The Cleanest Dirty Shirt in the Fiscal Laundry Basket"?

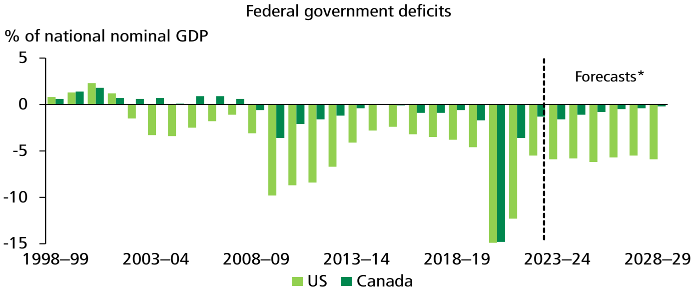
By Randall Bartlett, Senior Director of Canadian Economics

With Moody's cutting the US federal government's credit outlook to negative late last week amid ongoing political dysfunction in Washington, eyes have turned to Canada. In the lead-up to the Government of Canada's Fall Economic Statement (FES) this coming Tuesday, the key question is: Could Canada suffer a similar fate and possibly lose its triple-A credit rating?

In the short term, the answer is probably no. Canada is often called "the cleanest dirty shirt in the fiscal laundry basket." That's because when you juxtapose the federal government's deficit outlook here versus in the US, there is absolutely no comparison (graph 1). The US federal government is running, and plans to continue to run, unprecedented budget deficits outside of a recession. Canada is nowhere close. But that's the federal government. What about when you include states and provinces as well as local governments? Again, forget about it. Even when you compare Canada's public finances to other countries' on a consolidated basis as the IMF does, our deficits are smaller than those of our G7 peers, and Australia and Spain too (for those who don't believe the G7 alone is an apt comparator).

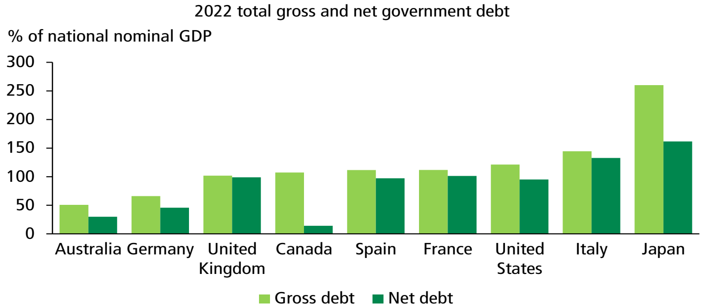
Turning to debt, again Canada places well. While Canada is near the middle of the pack in the G7 in terms of gross debt across all levels of government as a share of GDP, it comes in dead last for net debt (graph 2). This is largely the result of Canada's fully-funded national pension plans—the Canada Pension Plan and Quebec Pension Plan. Many other major advanced economies have looming future pension liabilities they haven't set aside sufficient funds for. But even removing pension funds from the net government debt calculation as we did in a report earlier this year, Canada continues to rank near the top of the leader board as one of the major advanced countries with the least indebted public sectors. This is also true when just isolating the central government.

GRAPH 1
Federal Deficits Are Projected to Be Much Smaller in Canada than in the US



*US forecasts are from the CBO in May 2023; Canadian forecasts are from the PBO in October 2023.
Sources: US Federal Government, Government of Canada, Congressional Budget Office (CBO), Parliamentary Budget Officer (PBO) and Desjardins Economic Studies

GRAPH 2
Canada's Net Government Debt Is Extremely Low as a Share of GDP



Sources: International Monetary Fund and Desjardins Economic Studies

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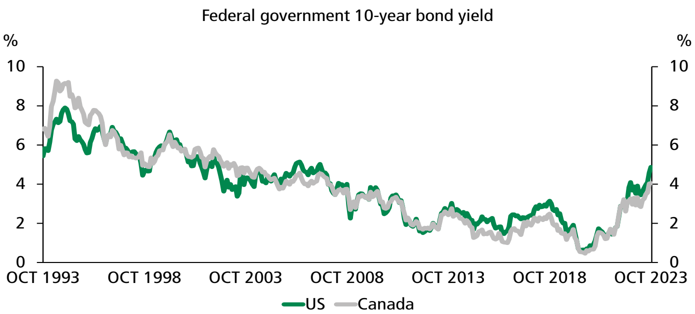
But here's the rub. Canada is generally a price taker when it comes to interest rates. Beyond the very short term, the Bank of Canada's policy rate has increasingly less influence over borrowing costs the further one goes out the yield curve. Instead, it's US bond yields that primarily determine Canadian government bond yields at, say, 10- and 30-year maturities. Because the US federal government has increased its borrowing program as interest from traditional US bond investors wanes, US Treasury yields have gone up. While this isn't something Canadian legislators can control, they will have to contend with the higher borrowing costs it entails (graph 3).

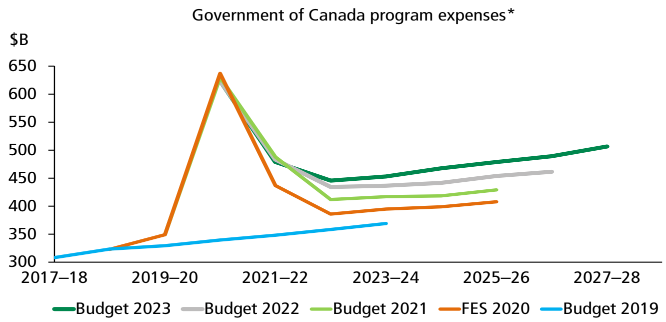
GRAPH 3
US Long-Term Bond Yields Influence Long-Term Yields in Canada



Sources: US Federal Reserve Board, Bank of Canada and Desjardins Economic Studies

Given the independence of the Bank of Canada and international influence on interest rates, the way governments in Canada can impact their borrowing costs is primarily through their own fiscal actions. As outlined previously, both consolidated and federal government deficits and debt as a share of GDP remain low in Canada relative to our international peers. But cracks are showing. First, the federal government has abandoned all ambition of ever returning to a balanced budget. And while fiscal forecasts show a return to a falling debt-to-GDP ratio at some point over the outlook, the Government of Canada's resolve to make this happen seems to weaken with each new projection published. This worsening deficit and debt profile is entirely the result of ever higher spending, with each new fiscal document outlining an expenditure track that is higher than the one before (graph 4).

GRAPH 4
Federal Spending Gets Higher with Each New Fiscal Forecast



Note: FES refers to Fall Economic Statement; program expenses include net actuarial losses.
Sources: Finance Canada and Desjardins Economic Studies

As we outlined in our recent federal FES preview, we think this trend toward ever higher spending is set to continue given the deluge of uncosted announcements recently. We just won't know by how much until the FES is published on Tuesday. However, ironically, only the federal government can reverse this expenditure trend. And it would be wise to do so before higher borrowing costs lead to deficit and debt dynamics that are beyond its control and ultimately take dramatic action to correct. Having the cleanest dirty shirt doesn't mean we should stain it further.

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

MONDAY November 20 - 10:00

October	m/m
Consensus	-0.6%
Desjardins	-0.7%
September	**-0.7%**

Leading indicator (October) – The leading indicator shed 0.7% in September, its steepest monthly slide since May. The October decline could be similar. Once again, the main detractors will likely be consumer confidence, the ISM index and the stock market. The leading indicator is again expected to take a 0.7% tumble, suggesting that the outlook for the US is still gloomy.

TUESDAY November 21 - 10:00

October	ann. rate
Consensus	3,900,000
Desjardins	3,970,000
September	**3,960,000**

Existing home sales (October) – Home resales fell for the fourth month in a row in September. The trend definitely seems to have shifted downward. But October probably brought some relief, as suggested by the 1.1% uptick in pending home sales. Preliminary regional data is telling the same story. We therefore expect existing home sales to have risen to 3,970,000 units. But downside risks remain, as soaring mortgage rates pushed mortgage applications for home purchases sharply lower in October.

WEDNESDAY November 22 - 8:30

October	m/m
Consensus	-3.2%
Desjardins	-4.1%
September	**4.6%**

Durable goods orders (October) – Nondefense aircraft orders skyrocketed 92.5% in September, driving the biggest monthly jump in durable goods orders since the summer of 2020. But we expect a weaker October print. Boeing data suggests aviation orders slowed significantly, and motor vehicle orders likely fell again after declining 1.0% in September. Excluding transportation, orders probably stalled in October after advancing 0.4% in September. This would be in line with last month's contraction in the ISM Manufacturing index and the slowdown in industrial production. We're anticipating a 4.1% slump in durable goods orders overall.

CANADA

TUESDAY November 21 - 8:30

October	m/m
Consensus	0.2%
Desjardins	0.1%
September	**-0.1%**

Consumer Price Index (October) – Headline consumer price growth likely fell to its slowest pace since June in October, rising just 3.1% on an annual basis. This drop from September's 3.8% reading is expected to be largely due to weaker global energy prices, which pushed domestic gasoline prices lower by nearly 7.0% in October. Excluding food and energy, core inflation likely remained steady at 3.2% year-over-year. That said, the 3-month annualized rate probably fell to 2.6% from 3.2% in September, pointing to further progress towards price stability. Outside of the traditional core inflation measure, the Bank of Canada will look for further progress on the median and trimmed-mean measures. These indicators have been hovering between 3% and 5% since last year, well above the Bank of Canada's inflation target range. With the economy cooling off and the more traditional measures of inflation slowing, the central bank's preferred indicators of underlying price pressures might also begin to show more progress.

FRIDAY November 24 - 8:30	
September	**m/m**
Consensus	0.0%
Desjardins	0.0%
August	**-0.1%**

Retail sales (September) – Retail sales were likely flat in September after decreasing slightly in August. Stronger auto sales—reflecting higher imports of passenger cars, light trucks and motor vehicle parts—probably propped up retail sales in September. We think prices also supported the headline number, albeit to a lesser extent. Gasoline prices remained high but largely unchanged after August's increase, mostly because of Saudi Arabia and Russia extending their voluntary oil production cut. We therefore expect the core retail sales print to be weaker. Looking ahead, we anticipate Statistics Canada's flash estimate for October to show flat or slightly decreasing retail trade with stable auto sales and declining gasoline prices during the month.

OVERSEAS

THURSDAY November 23 - 4:00	
November	
Consensus	46.9
October	**46.5**

Eurozone: Purchasing Managers' Index (November – preliminary) – After edging up in September, the eurozone composite PMI slipped back from 47.2 to 46.5 in October. While the manufacturing component remained sluggish, the pullback was mostly due to a deterioration in the services PMI. Aside from its September bounce, the composite PMI has been on a downtrend since May. Its current level remains consistent with a quarterly decline in eurozone real GDP. November's print will tell us whether the economy is likely to struggle further at the end of 2023.

Economic Indicators

Week of November 20 to 24, 2023

Day	Time	Indicator	Period	Consensus	Desjardins	Previous reading
UNITED STATES						
MONDAY 20	10:00	Leading indicator (m/m)	Oct.	-0.6%	-0.7%	-0.7%
	12:00	Speech by Federal Reserve Bank of Richmond President T. Barkin				
TUESDAY 21	10:00	Existing home sales (ann. rate)	Oct.	3,900,000	3,970,000	3,960,000
	14:00	Release of the Federal Reserve's meeting minutes				
WEDNESDAY 22	8:30	Initial unemployment claims	Nov. 13–18	225,000	228,000	231,000
	8:30	Durable goods orders (m/m)	Oct.	-3.2%	-4.1%	4.6%
	10:00	University of Michigan consumer sentiment index – final	Nov.	61.0	60.4	60.4
THURSDAY 23	---	Markets closed (Thanksgiving Day)				
FRIDAY 24	---	---				
CANADA						
MONDAY 20	---	---				
TUESDAY 21	8:30	Consumer price index				
		Total (m/m)	Oct.	0.2%	0.1%	-0.1%
		Total (y/y)	Oct.	3.2%	3.1%	3.8%
	---	Federal Government's 2023 Economic and Fiscal Update				
WEDNESDAY 22	11:15	Speech by Bank of Canada Governor T. Macklem				
THURSDAY 23	---	---				
FRIDAY 24	8:30	Retail sales				
		Total (m/m)	Sept.	0.0%	0.0%	-0.1%
		Excluding automobiles (m/m)	Sept.	-0.3%	-0.3%	0.1%

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 Standard Time (GMT - 5 hours). Desjardins Economic Studies forecast.

Economic Indicators

Week of November 20 to 24, 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 20							
Germany	2:00	Consumer confidence	Oct.	0.0%	-11.0%	-0.2%	-14.7%
Eurozone	5:00	Construction	Sept.	n/a	n/a	-1.1%	-0.1%
TUESDAY 21							
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WEDNESDAY 22							
Eurozone	10:00	Consumer confidence – preliminary	Nov.	-17.7		-17.9	
THURSDAY 23							
France	2:45	Business confidence	Nov.	98		98	
France	2:45	Production outlook	Nov.	-8		-10	
France	3:15	Composite PMI – preliminary	Nov.	44.6		44.6	
France	3:15	Manufacturing PMI – preliminary	Nov.	43.1		42.8	
France	3:15	Services PMI – preliminary	Nov.	45.5		45.2	
Germany	3:30	Composite PMI – preliminary	Nov.	46.3		45.9	
Germany	3:30	Manufacturing PMI – preliminary	Nov.	41.1		40.8	
Germany	3:30	Services PMI – preliminary	Nov.	48.4		48.2	
Sweden	3:30	Bank of Sweden meeting	Nov.	4.25%		4.00%	
Eurozone	4:00	Composite PMI – preliminary	Nov.	46.9		46.5	
Eurozone	4:00	Manufacturing PMI – preliminary	Nov.	43.3		43.1	
Eurozone	4:00	Services PMI – preliminary	Nov.	48.0		47.8	
United Kingdom	4:30	Composite PMI – preliminary	Nov.	48.4		48.7	
United Kingdom	4:30	Manufacturing PMI – preliminary	Nov.	45.0		44.8	
United Kingdom	4:30	Services PMI – preliminary	Nov.	49.5		49.5	
Japan	18:30	Consumer price index	Oct.		3.4%		3.0%
United Kingdom	19:01	Consumer confidence	Nov.	-27		-30	
Japan	19:30	Composite PMI – preliminary	Nov.	n/a		50.5	
Japan	19:30	Manufacturing PMI – preliminary	Nov.	n/a		48.7	
Japan	19:30	Services PMI – preliminary	Nov.	n/a		51.6	
FRIDAY 24							
Japan	0:00	Leading indicator – final	Sept.	n/a		108.7	
Japan	0:00	Coincident index – final	Sept.	n/a		114.7	
Germany	2:00	Real GDP – final	Q3	-0.1%	-0.3%	-0.1%	-0.3%
Germany	4:00	ifo Business Climate Index	Nov.	87.5		86.9	
Germany	4:00	ifo Current Assessment Index	Nov.	89.5		89.2	
Germany	4:00	ifo Expectations Index	Nov.	85.7		84.7	

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 Standard Time (GMT - 5 hours).