WEEKLY COMMENTARY

My Spending Is Your Income and Your Spending Is My Income

By Royce Mendes, Managing Director and Head of Macro Strategy

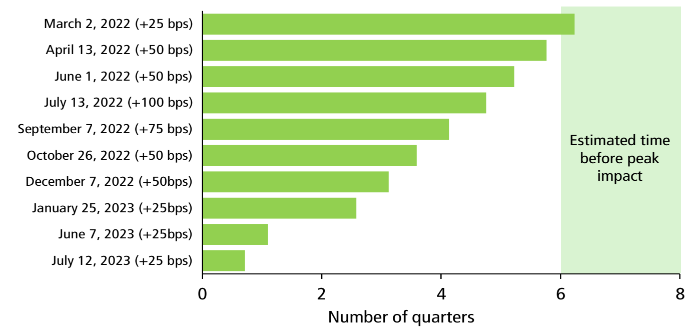
Bank of Canada rate hikes might be in the rearview mirror, but the economic impacts are just getting started. It's often said that changes in monetary policy take almost two years to fully make their way through the economy. It's been just a year and a half since the Bank of Canada began raising rates and only a little longer since bond yields started moving higher. Based on the conventional thinking about monetary policy, much of the impacts are yet to come (graph 1). What's concerning is that the economy stalled in the second quarter.

Households are already back allocating almost 15% of their disposable income to servicing debt. That's roughly in line with the pre-Covid trend, even though many mortgage holders are still locked in at the low interest rates they received in 2020 and 2021. As time passes, more money will be devoted to debt service even without any further rate increases. No fancy modelling is needed to understand this concept. Many Canadians are dreading renewing their mortgage in this high interest rate environment. But each month, roughly 2% of mortgage holders face that prospect.

It's difficult to say with any precision how hard rate hikes will eventually bite given all of the moving parts and the fact that the economy has changed so much in the past few decades. On average, Canadian households are shouldering 50% more debt relative to their incomes than they were 20 years ago. At the least, that points to an economy that is far more sensitive to interest rate changes than it was in the early 2000s.

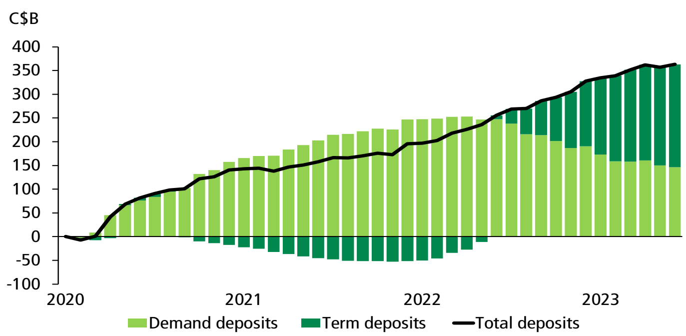
It's once again become attractive for Canadians to park money in term deposits, with many yielding over 5% annual returns for terms spanning years into the future. As more money gets tucked away under the proverbial mattresses of Canadians, it's leaving less cash in households' chequing accounts to spend on goods and services in the economy (graph 2).

GRAPH 1
Time Elapsed Since Rate Hike



Source: Desjardins Economic Studies

GRAPH 2
Cumulative Change in Personal Deposits at Banks



Sources: Bank of Canada and Desjardins Economic Studies

Since my spending is your income and your spending is my income, the incentive to save or service debt instead of spend is a powerful force in slowing economic activity. We expect that it will ultimately tip the economy into recession. The silver lining is

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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.

that, should a recession be enough to pull inflation back down to target, central bankers will be able to ease up on the brake pedal in 2024 by trimming interest rates. A far worse outcome would see inflation becoming more entrenched, leaving monetary policymakers with no choice but to raise rates further.

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

TUESDAY Sept. 19 - 8:30

August	ann. rate
Consensus	1,435,000
Desjardins	1,430,000
July	**1,452,000**

Housing starts (August) – Housing starts have been up and down, spiking 17.4% in May before falling 11.7% in June and picking up 3.9% in July. We expect the August print to show a new decline, albeit a modest one. Building permits saw a big drop in June and were relatively unchanged in July, but there's been a slight rise in residential construction jobs. We think housing starts will come in at 1,430,000 units.

WEDNESDAY Sept. 20 - 14:00

September	
Consensus	5.50%
Desjardins	5.50%
July 26	**5.50%**

Federal Reserve meeting (September) – This spring's expectations of a pause in rate hikes, or even the end of the monetary tightening cycle, ended up being short-lived. After leaving rates unchanged in June, the Fed announced a fresh hike in late July. Another pause is now likely in September. Economic indicators and price indexes still haven't slowed enough to declare victory—far from it. In his Jackson Hole speech, Jerome Powell said that "we will proceed carefully as we decide whether to tighten further or, instead, to hold the policy rate constant and await further data." It's clear Fed officials are treading a fine line between these two options, but we think they're more likely to hold things steady for now. A longer pause could even be in the cards, provided the economy, the job market and inflation cool off enough. We'll be interested to see what Fed officials are now forecasting for the economy and future rate changes.

THURSDAY Sept. 21 - 10:00

August	m/m
Consensus	-0.5%
Desjardins	-0.6%
July	**-0.4%**

Leading indicator (August) – The leading indicator points to a more pronounced slowdown in the US economy. There hasn't been a month-over-month increase since March 2022, and we've seen 13 months of year-over-year declines in a row. We're expecting another monthly decrease for August. The biggest detractors are likely to be the ISM index, consumer confidence and the interest rate spread. The leading indicator could fall by 0.6%.

THURSDAY Sept. 21 - 10:00

August	ann. rate
Consensus	4,100,000
Desjardins	4,120,000
July	**4,070,000**

Existing home sales (August) – In July, existing home sales fell to their lowest level since January. Rising mortgage rates over the summer began affecting loan applications, which spread to real activity on the existing home market. But after a total drop of 5.3% in June and July, we expect sales to have gone up slightly in August, based on pending sales and preliminary regional data.

CANADA

MONDAY Sept. 18 - 8:15

August	ann. rate
Consensus	252,500
Desjardins	250,000
July	**255,000**

Housing starts (August) – We expect Canada-wide housing starts to have eased towards about 250k units in July. That expectation reflects the soft patch in construction employment observed in recent months, as well as the lingering effects of slowing economic growth and sharply higher interest rates. High material costs and labour shortages are also frequently cited as factors likely to hold back new homebuilding going forward, though a spike in residential building permit values last month doesn't suggest a huge slowdown is imminent. We'll continue to watch for regional differences. So far in 2023, starts have proved remarkably resilient to a souring economic backdrop in Ontario and BC despite those provinces' outsized vulnerability to a housing-induced economic slowdown. By contrast, Quebec and Alberta have been laggards.

TUESDAY Sept. 19 - 8:30	
August	**m/m**
Consensus	0.2%
Desjardins	0.3%
July	**0.6%**

Consumer Price Index (August) – The annual pace of headline inflation likely accelerated for a second straight month in August, rising to 3.9%. That would mark the fastest reported pace since April, but much of that increase is probably due to gasoline prices, which jumped about 6% from July to August. Excluding food and energy, inflation likely hovered around 3.5%, although a rebound in cellphone service prices probably pushed price growth higher than it would have otherwise been. We see both the 3-month annualized and year-over-year figures for the two core Bank of Canada measures remaining unchanged at around 3.5%. Any progress in these measures towards the 2% target will help reassure Canadian central bankers of their current policy stance.

FRIDAY Sept. 22 - 8:30	
July	**m/m**
Consensus	0.4%
Desjardins	0.4%
June	**0.1%**

Retail sales (July) – Retail sales likely increased in July for the fourth consecutive month. Our forecast calls for a 0.4% increase, in line with Statistics Canada's flash estimate. Weaker auto sales were probably a headwind in July, so we expect the core retail sales print to be stronger. We think the headline number will be supported by volumes as prices were likely flat. Statistics Canada's flash estimate for August should show growth picking up again on the back of a modest uptick in auto sales in the month.

OVERSEAS

THURSDAY Sept. 21 - 7:00	
September	
Consensus	5.50%
Desjardins	5.50%
August 3	**5.25%**

United Kingdom: Bank of England meeting (September) – While UK inflation has come down considerably in recent months, it's still well above target (August's print will be published on Wednesday, September 20). It's also higher than in other major advanced economies. That means there's still room for more monetary tightening, especially with much of the economic data not showing a pronounced slowdown of the economy. The job market remains tight and wage growth is still strong. We'll be interested to see whether the Bank of England (BoE) lays the groundwork for a pause at its next monetary policy meetings, or if they'll be leaving the door open for further rate hikes. At 5.50%, the BoE's main Bank Rate is the highest in the G7, but that's often been the case during past monetary tightening cycles.

FRIDAY Sept. 22	
September	
Consensus	-0.10%
Desjardins	0.00%
July 28	**-0.10%**

Japan: Bank of Japan meeting (September) – The Bank of Japan (BoJ) is the only central bank of the advanced economies not to have raised its policy interest rate, which has been in negative territory (-0.1%) for several years. In July, the BoJ decided to ease its yield curve controls, which sent the 10-year Japanese bond yield above 0.50%. We think they might announce a 0.1% hike, bringing the policy rate to 0.0%. The Japanese economy is doing well, and it increasingly looks like inflation might be settling in above the target of 2%. Scarred by a long battle with deflation, the BoJ is treading carefully, making sure the rise in inflation isn't just another mirage. That said, it wouldn't be an enormous risk to raise its policy rate by 0.1%, which could barely be considered monetary tightening. But it could add upward pressure on Japanese bond yields and send the yen higher. We'll also be keeping an eye out for Japan's August CPI print, which is set to be published Thursday evening.

FRIDAY Sept. 22 - 4:00	
September	
Consensus	46.7
August	**46.7**

Eurozone: Purchasing Managers' Index (September – preliminary) – The eurozone composite Purchasing Managers' Index (PMI) has been trending down since April, falling from 54.1 to 46.7 in August. While the weakness was initially concentrated in the manufacturing sector, last month also saw the services index fall below the 50-point mark. The readings are consistent with an economy battered by rate hikes, tighter credit conditions, weak consumer confidence and economic uncertainty. Another decline in September, particularly on the services side, would signal persisting economic challenges for the eurozone.

Economic Indicators

Week of September 18 to 22, 2023

Date	Time	Indicator	Period	Consensus		Previous reading
UNITED STATES						
MONDAY 18	10:00	NAHB housing market index	Sept.	49	n/a	50
	16:00	Net foreign securities purchases (US$B)	July	n/a	n/a	195.9
TUESDAY 19	8:30	Housing starts (ann. rate)	Aug.	1,435,000	1,430,000	1,452,000
	8:30	Building permits (ann. rate)	Aug.	1,440,000	1,430,000	1,443,000
WEDNESDAY 20	14:00	Federal Reserve meeting	Sept.	5.50%	5.50%	5.50%
	14:30	Speech by Federal Reserve Chair J. Powell				
THURSDAY 21	8:30	Initial unemployment claims	Sept. 11–15	224,000	224,000	220,000
	8:30	Current account (US$B)	Q2	-221.2	-222.0	-219.3
	8:30	Philadelphia Fed index	Sept.	-1.4	-5.0	12.0
	10:00	Leading indicator (m/m)	Aug.	-0.5%	-0.6%	-0.4%
	10:00	Existing home sales (ann. rate)	Aug.	4,100,000	4,120,000	4,070,000
FRIDAY 22	8:50	Speech by Federal Reserve Governor L. Cook				
	13:00	Speech by Federal Reserve Bank of San Francisco President M. Daly				
CANADA						
MONDAY 18	8:15	Housing starts (ann. rate)	Aug.	252,500	250,000	255,000
	8:30	Industrial product price index (m/m)	Aug.	0.1%	0.8%	0.4%
	8:30	Raw materials price index (m/m)	Aug.	n/a	1.2%	3.5%
TUESDAY 19	8:30	Consumer price index				
		Total (m/m)	Aug.	0.2%	0.3%	0.6%
		Total (y/y)	Aug.	3.8%	3.9%	3.3%
	13:45	Speech by Bank of Canada Deputy Governor S. Kozicki				
WEDNESDAY 20	13:30	Release of the Bank of Canada Summary of Deliberations				
THURSDAY 21	---	---				
FRIDAY 22	8:30	Retail sales				
		Total (m/m)	July	0.4%	0.4%	0.1%
		Excluding automobiles (m/m)	July	0.3%	0.5%	-0.8%

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 18 to 22, 2023

Country	Time	Indicator	Period	Consensus		Previous reading	
				m/m (q/q)	y/y	m/m (q/q)	y/y
OVERSEAS							
MONDAY 18							
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TUESDAY 19							
Eurozone	4:00	Current account (€B)	July	n/a		35.8	
Italy	4:30	Current account (€M)	July	n/a		5,995	
Eurozone	5:00	Consumer price index – final	Aug.	0.6%	5.3%	0.6%	5.3%
Japan	19:50	Trade balance (¥B)	Aug.	-441.1		-557.2	
WEDNESDAY 20							
United Kingdom	2:00	Consumer price index	Aug.	0.7%	7.1%	-0.4%	6.8%
United Kingdom	2:00	Producer price index	Aug.	0.2%	-0.6%	0.1%	-0.8%
Germany	2:00	Producer price index	Aug.	0.2%	-12.6%	-1.1%	-6.0%
Eurozone	5:00	Construction	July	n/a	n/a	-1.0%	-0.3%
Brazil	17:30	Central Bank of Brazil meeting	Sept.	12.75%		13.25%	
THURSDAY 21							
Japan	---	Bank of Japan meeting	Sept.	-0.10%		-0.10%	
France	2:45	Business confidence	Sept.	98		99	
France	2:45	Production outlook	Sept.	-9		-9	
Sweden	3:30	Bank of Sweden meeting	Sept.	4.00%		3.75%	
Switzerland	3:30	Swiss National Bank meeting	Sept.	2.00%		1.75%	
Norway	4:00	Bank of Norway meeting	Sept.	4.25%		4.00%	
United Kingdom	7:00	Bank of England meeting	Sept.	5.50%		5.25%	
Eurozone	10:00	Consumer confidence – preliminary	Sept.	-16.5		-16.0	
United Kingdom	19:01	Consumer confidence	Sept.	-26		-25	
Japan	19:30	Consumer price index	Aug.		3.0%		3.3%
Japan	20:30	Composite PMI – preliminary	Sept.	n/a		52.6	
Japan	20:30	Manufacturing PMI – preliminary	Sept.	n/a		49.6	
Japan	20:30	Services PMI – preliminary	Sept.	n/a		54.3	
FRIDAY 22							
United Kingdom	2:00	Retail sales	Aug.	0.5%	-1.2%	-1.2%	-3.2%
France	3:15	Composite PMI – preliminary	Sept.	46.0		46.0	
France	3:15	Manufacturing PMI – preliminary	Sept.	46.2		46.0	
France	3:15	Services PMI – preliminary	Sept.	46.0		46.0	
Germany	3:30	Composite PMI – preliminary	Sept.	44.9		44.6	
Germany	3:30	Manufacturing PMI – preliminary	Sept.	39.5		39.1	
Germany	3:30	Services PMI – preliminary	Sept.	47.2		47.3	
Eurozone	4:00	Composite PMI – preliminary	Sept.	46.7		46.7	
Eurozone	4:00	Manufacturing PMI – preliminary	Sept.	44.0		43.5	
Eurozone	4:00	Services PMI – preliminary	Sept.	47.7		47.9	
United Kingdom	4:30	Composite PMI – preliminary	Sept.	48.8		48.6	
United Kingdom	4:30	Manufacturing PMI – preliminary	Sept.	43.4		43.0	
United Kingdom	4:30	Services PMI – preliminary	Sept.	49.0		49.5	

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).