# WEEKLY COMMENTARY

## Getting Comfortable with "Transitory" Again

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

In Canada, nothing breaks the ice better than a discussion about housing, and the Bank of Canada Governor has a few thoughts on the topic. Tiff Macklem contends that monetary policy shouldn't be counted upon to improve housing affordability given the structural constraints in the homebuilding sector. Yes, addressing the housing shortage will require a multifaceted approach. But monetary policy does play a role in supply. For example, Quebec's home building industry is more concentrated in purpose built rentals than elsewhere. Internal rate of return calculations play a much bigger role in the decision to build purpose-built rental housing than in the decision to build condos, which rely heavily on presales. This partly explains the significant 32% drop in housing starts in Quebec in 2023, which contrasted with more resilient outcomes in cities like Vancouver and Toronto. While other policy tools and industry sector innovations should unquestionably be prioritized to help expand housing supply, the role of restrictive financing conditions shouldn't be downplayed.

The fact that the Bank of Canada Governor addressed the issue of housing in his speech is also related to the fact that, to a large extent, Canada's inflation persistence reduces to the impact of shelter. Excluding shelter, inflation is running at a quite benign 2.4% year-over-year. The central question for the Bank of Canada should therefore be whether the economy is slowing enough to believe cycle-sensitive inflation components will continue to cool sufficiently to bring headline inflation down to 2% reasonably soon.

We don't see any real reason to doubt the effectiveness of Canada's current monetary policy. Were it not for historically strong demographic growth, monetary policy would have tipped Canada into a recession last year. As the economy forges deeper into excess capacity, rate cuts will become warranted in the near future. But the Bank of Canada will need to live with a few things as this process unfolds.

Will there be a response in home sales and prices? Probably, yes. In fact, data for Montreal, Toronto and Vancouver suggests buyers have started to come off the sidelines lately. But there's a difference between a transitory, pent-up-demand-driven rebound and a strong, sustained housing market rally.

It's not just the daunting affordability economics that challenge many buyers today, but the broader economic landscape has shifted significantly in the past year. Early last year when the housing market recovered, the unemployment rate was at 4.9% and insolvency rates were relatively low. Fast forward to today, and we've learned that consumer insolvencies surged by 23% in 2023. Meanwhile the unemployment rate has climbed to 5.7% and probably hasn't peaked, financial institutions have tightened their lending conditions, and households are hesitant to make major purchases.

What if we're underestimating pent-up demand? If demand proves stronger than anticipated, prices and affordability will naturally adjust to bring the market into balance with the available supply. Given today's record-low affordability, it wouldn't be misguided for the Bank to adopt a hands-off approach and allow market dynamics to regulate housing activity.

What else will central bankers need to be at peace with? Supply shocks. Before the pandemic, supply shocks were a normal part of life that didn't typically cause central bankers to lose sleep. So it's at least encouraging to see the Governor again acknowledge the transitory nature of some factors. In a note next week, we'll tease out some of the ways shipping disruptions in the Red Sea could affect inflation if freight prices remain elevated. But it's more likely that these disruptions are just transitory. That's why it's central bank best practice to discount relative price shocks of this variety.

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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.

Even when we think back to the pandemic, it wasn't so much supply chains that prompted the aggressive monetary policy response to inflation, because central banks correctly identified the supply chain disruptions as temporary. Arguably to a greater extent, it was a confluence of demand-boosting fiscal policies, supply shocks via public health restrictions, and the war in Ukraine which acted as an accelerant, that collectively told central banks they needed to react forcefully. The parallels between current supply chain disruptions and the pandemic are therefore quite limited. What we're seeing right now is in all likelihood a transitory shock, and central bankers are well within their right to say so. Hopefully they will. Because truth be told, if they wait for guarantees—whether on supply shocks, housing gyrations, wages, short-term inflation measures or government spending—there will always be a good excuse to delay rate cuts.

# 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 February 13 - 8:30

| January | m/m |
|---|---|
| Consensus | 0.2% |
| Desjardins | 0.1% |
| **December** | **0.2%** |

**Consumer Price Index (January) –** US headline inflation briefly paused its decline at the end of 2023. The year-on-year change in the Consumer Price Index increased from 3.1% in November to 3.4% in December, the first uptick since August. But we expect the slowdown to have resumed in earnest in January. Another dip in gasoline prices probably helped limit the month-on-month increase in headline CPI to no more than 0.1%. The monthly change in food prices likely came in at 0.2%, as it did in November and December. That said, the January cold snap may have caused some prices to spike. We expect core CPI, which strips out food and energy, to have advanced 0.3%, as it did in the final two months of 2023. Motor vehicle prices likely lost ground. The all items index probably retreated from 3.4% to 2.9% year-on-year. This would be the first time inflation fell below 3% since March 2021. Core inflation likely slowed from 3.9% to 3.7%.

THURSDAY February 15 - 8:30

| January | m/m |
|---|---|
| Consensus | -0.2% |
| Desjardins | 0.1% |
| **December** | **0.6%** |

**Retail sales (January) –** US retail sales continued their sharp climb at the end of 2023. We expect total sales growth to have cooled in the first month of 2024, mainly due to motor vehicles and gasoline prices. For motor vehicles, the 6.9% decrease in new vehicle sales in January suggests that nominal sales at dealerships plummeted. Gasoline prices continued to slide in January, suggesting that gasoline station sales slowed once more. Preliminary card transaction data revealed that sales for other retail categories were up. That said, card transaction data hasn't been very reliable in recent months. In addition, after an unseasonably warm December, the bitter cold in January probably fuelled sales volatility, depending on the retail category. Meanwhile consumer confidence picked up, but this good news was tempered by a 1.5% downshift in retail hours worked (despite the 45,200 jobs added in this sector). Overall, we expect total retail sales to have grown by 0.1%, with sales excluding motor vehicles and gasoline ticking up by 0.7%.

THURSDAY February 15 - 9:15

| January | m/m |
|---|---|
| Consensus | 0.3% |
| Desjardins | -0.1% |
| **December** | **0.1%** |

**Industrial production (January) –** After two straight months of declines in October and November, industrial production edged up 0.1% in December. However, we expect it to have gone down again in January. This contraction was likely due in large part to last month's cold snap, which followed an unusually balmy December. Hours worked in resources and manufacturing (especially auto) also plummeted. In addition, manufacturing output probably shrank by 0.4%. But the impact on total industrial production was probably largely offset by a rebound in energy production driven by increased heating demand. Total industrial production likely dipped 0.1%.

FRIDAY February 16 - 8:30

| January | ann. rate |
|---|---|
| Consensus | 1,465,000 |
| Desjardins | 1,445,000 |
| **December** | **1,460,000** |

**Housing starts (January) –** After jumping 10.8% in November, housing starts fell 4.3% to 1,460,000 units in December. This is still relatively high—the average in 2023 was 1,415,000 units. We expect an additional pullback in January, if only because the weather wasn't as good for new construction as it was in December. In addition, hours worked in construction dropped 0.8% last month. Building permits are expected to have slipped to a still relatively high 1,475,000 units.

| FRIDAY February 16 - 10:00 | |
|---|---|
| **February** | |
| Consensus | 80.0 |
| Desjardins | 77.5 |
| **January** | **79.0** |

**University of Michigan consumer sentiment index (February, preliminary) –** US consumer confidence is on the rise. Most indexes climbed sharply in the final months of 2023 and January 2024. The preliminary reading of the University of Michigan index will give us an idea of whether the uptrend continued in February. For the time being, we expect sentiment to have weakened somewhat. The stock market has made solid gains since the month began, but gasoline prices have started moving back up after retreating again in January. Mortgage rates also ticked higher. Meanwhile the TIPP index faltered slightly in February. The University of Michigan's consumer sentiment index probably slid from 79 to 77.5.

## CANADA

| WEDNESDAY February 14 - 9:00 | |
|---|---|
| **January** | **m/m** |
| Consensus | n/a |
| Desjardins | 7.0% |
| **December** | **8.7%** |

**Existing home sales (January) –** We're penciling in a 7% gain for national-level home sales in January, figures for which are due out on Wednesday. Preliminary data from nearly every local real estate board suggests huge increases versus year-ago levels to begin 2024. That at least partly reflects weaker bond yields, which have put downward pressure on mortgage rates over the past month. However, as we highlighted two weeks ago, sizeable seasonal adjustment factors for December and January data mean that a much larger increase is possible. Accordingly, we may not get a clearer picture of the strength of the rebound for another few months. We'll also be closely watching new listings, which appear to have followed sales higher amid signs of stronger homebuying demand and still-elevated borrowing costs.

| THURSDAY February 15 - 8:15 | |
|---|---|
| **January** | **ann. rate** |
| Consensus | n/a |
| Desjardins | 230,000 |
| **December** | **249,300** |

**Housing starts (January) –** We're expecting January 2024 data—set for release on Thursday—to show that Canadian housing starts dipped to 230k (annualized). Our call is based on fundamentals, as starts are one of the first economic indicators released for the month and we don't have much early information. Rates, building costs, homebuilder sentiment and construction industry labour shortages all point to much weaker building activity going forward. The key question in our view is the timing of the slowdown in Toronto and Vancouver, where resilient housing starts last year reflected projects financed before borrowing costs surged and the macroeconomic backdrop deteriorated.

| THURSDAY February 15 - 8:30 | |
|---|---|
| **December** | **m/m** |
| Consensus | n/a |
| Desjardins | -0.6% |
| **November** | **1.2%** |

**Manufacturing sales (December) –** Manufacturing sales are expected to have declined by 0.6% in December, in line with Statistics Canada's flash estimate. All of this weakness is likely to have been a price story, with the seasonally adjusted Industrial Products Price Index having fallen by about 0.8% in the month.

## OVERSEAS

| WEDNESDAY February 14 - 2:00 | |
|---|---|
| **Q4 2023** | **q/q** |
| Consensus | -0.1% |
| **Q3 2023** | **-0.1%** |

**United Kingdom: Real GDP (fourth quarter) –** Did the UK slip into a technical recession in the second half of 2023? UK real GDP may have followed up its 0.1% non-annualized decline in the third quarter with another downturn in the fourth. It all hinges on the December reading, since the October and November prints pointed to a negative carryover of 0.1%. The plunge in UK retail sales in December—the worst showing since January 2021—does not bode well.

| WEDNESDAY February 14 - 18:50 | |
|---|---|
| **Q4 2023** | **q/q** |
| Consensus | 0.3% |
| **Q3 2023** | **-0.7%** |

**Japan: Real GDP (fourth quarter) –** Although Japanese real GDP grew 0.9% on a non-annualized basis in the second quarter of 2023, this surge was driven by a brief spike in exports. If we take a closer look at the numbers, we see that real consumption waned over the spring and summer, contributing to the 0.7% real GDP contraction in the third quarter. As for the end of 2023, both consumer spending and investment flagged in October and November. Japan's economy may therefore have contracted again in the last quarter, bringing real GDP growth to 1.7% for the year as a whole.

# Economic Indicators

## Week of February 12 to 16, 2024

| Day | Time | Indicator | Period | Consensus | Desjardins | Previous reading |
|---|---|---|---|---|---|---|
| **UNITED STATES** | | | | | | |
| MONDAY 12 | 14:00 | Federal budget (US$B) | Jan. | -40.0 | -21.0 | -129.4 |
| TUESDAY 13 | 8:30 | Consumer price index | | | | |
| | | Total (m/m) | Jan. | 0.2% | 0.1% | 0.2% |
| | | Excluding food and energy (m/m) | Jan. | 0.3% | 0.3% | 0.3% |
| | | Total (y/y) | Jan. | 2.9% | 2.9% | 3.4% |
| | | Excluding food and energy (y/y) | Jan. | 3.7% | 3.7% | 3.9% |
| WEDNESDAY 14 | --- | --- | | | | |
| THURSDAY 15 | 8:30 | Initial unemployment claims | Feb. 5–9 | 216,000 | 222,000 | 218,000 |
| | 8:30 | Philadelphia Fed index | Feb. | -9.0 | -10.0 | -10.6 |
| | 8:30 | Empire State Manufacturing Index | Feb. | -11.8 | -10.0 | -43.7 |
| | 8:30 | Export prices (m/m) | Jan. | -0.2% | 0.4% | -0.9% |
| | 8:30 | Import prices (m/m) | Jan. | -0.1% | 0.0% | 0.0% |
| | 8:30 | Retail sales | | | | |
| | | Total (m/m) | Jan. | -0.2% | 0.1% | 0.6% |
| | | Excluding automobiles (m/m) | Jan. | 0.1% | 0.6% | 0.4% |
| | 9:15 | Industrial production (m/m) | Jan. | 0.3% | -0.1% | 0.1% |
| | 9:15 | Production capacity utilization rate | Jan. | 78.9% | 78.4% | 78.6% |
| | 10:00 | NAHB housing market index | Feb. | 46 | n/a | 44 |
| | 10:00 | Business inventories (m/m) | Dec. | 0.4% | 0.4% | -0.1% |
| | 16:00 | Net foreign securities purchases (US$B) | Dec. | n/a | n/a | 126.1 |
| FRIDAY 16 | 8:30 | Producer price index | | | | |
| | | Total (m/m) | Jan. | 0.1% | -0.1% | -0.1% |
| | | Excluding food and energy (m/m) | Jan. | 0.1% | 0.0% | 0.0% |
| | 8:30 | Housing starts (ann. rate) | Jan. | 1,465,000 | 1,445,000 | 1,460,000 |
| | 8:30 | Building permits (ann. rate) | Jan. | 1,515,000 | 1,475,000 | 1,493,000 |
| | 10:00 | University of Michigan consumer sentiment index – preliminary | Feb. | 80.0 | 77.5 | 79.0 |
| **CANADA** | | | | | | |
| MONDAY 12 | --- | --- | | | | |
| TUESDAY 13 | --- | --- | | | | |
| WEDNESDAY 14 | 9:00 | Existing home sales (m/m) | Jan. | n/a | 7.0% | 8.7% |
| | 14:30 | Speech by Bank of Canada Deputy Governor R. Mendes | | | | |
| THURSDAY 15 | 8:15 | Housing starts (ann. rate) | Jan. | n/a | 230,000 | 249,300 |
| | 8:30 | Manufacturing sales (m/m) | Dec. | n/a | -0.6% | 1.2% |
| FRIDAY 16 | 8:30 | International securities transactions ($B) | Dec. | n/a | n/a | 11.43 |
| | 8:30 | Wholesale sales (m/m) | Dec. | n/a | 0.8% | 0.9% |

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 February 12 to 16, 2024

| Country | Time | Indicator | Period | Consensus m/m (q/q) | Consensus y/y | Previous reading m/m (q/q) | Previous reading y/y |
|---|---|---|---|---|---|---|---|
| **OVERSEAS** | | | | | | | |
| **MONDAY 12** | | | | | | | |
| Japan | 18:50 | Producer price index | Jan. | 0.1% | 0.1% | 0.3% | 0.0% |
| **TUESDAY 13** | | | | | | | |
| Germany | --- | Current account (€B) | Dec. | n/a | | 30.8 | |
| France | 1:30 | ILO unemployment rate | Q4 | 7.4% | | 7.4% | |
| United Kingdom | 2:00 | ILO unemployment rate | Dec. | 4.0% | | 4.2% | |
| Germany | 5:00 | ZEW Current Conditions Survey | Feb. | -79.0 | | -77.3 | |
| Germany | 5:00 | ZEW Expectations Survey | Feb. | 17.3 | | 15.2 | |
| **WEDNESDAY 14** | | | | | | | |
| United Kingdom | 2:00 | Trade balance (£M) | Dec. | -1,850 | | -1,408 | |
| United Kingdom | 2:00 | Construction | Dec. | -0.2% | -1.3% | -0.2% | 0.9% |
| United Kingdom | 2:00 | Consumer price index | Jan. | -0.3% | 4.2% | 0.4% | 4.0% |
| United Kingdom | 2:00 | Producer price index | Jan. | -0.2% | -0.5% | -0.6% | 0.1% |
| United Kingdom | 2:00 | Index of services | Dec. | -0.2% | | 0.4% | |
| United Kingdom | 2:00 | Monthly GDP | Dec. | -0.2% | | 0.3% | |
| United Kingdom | 2:00 | Real GDP – preliminary | Q4 | -0.1% | 0.1% | -0.1% | 0.3% |
| United Kingdom | 2:00 | Industrial production | Dec. | -0.1% | -0.4% | 0.3% | -0.1% |
| Eurozone | 5:00 | Net change in employment – preliminary | Q4 | n/a | n/a | 0.2% | 1.3% |
| Eurozone | 5:00 | Real GDP – preliminary | Q4 | 0.0% | 0.1% | 0.0% | 0.1% |
| Eurozone | 5:00 | Industrial production | Dec. | -0.2% | 4.1% | -0.3% | -6.8% |
| Japan | 18:50 | Real GDP – preliminary | Q4 | 0.3% | | -0.7% | |
| Japan | 23:30 | Industrial production – final | Dec. | n/a | n/a | 1.8% | -0.7% |
| **THURSDAY 15** | | | | | | | |
| Italy | 4:00 | Trade balance (€M) | Dec. | n/a | | 3,889 | |
| Eurozone | 5:00 | Trade balance (€B) | Dec. | n/a | | 14.8 | |
| Japan | 23:30 | Tertiary Industry Activity Index | Dec. | 0.2% | | -0.7% | |
| **FRIDAY 16** | | | | | | | |
| United Kingdom | 2:00 | Retail sales | Jan. | 1.5% | -1.6% | -3.2% | -2.4% |
| France | 2:45 | Consumer price index – final | Jan. | -0.2% | 3.1% | -0.2% | 3.1% |
| Russia | 5:30 | Bank of Russia meeting | Feb. | 16.00% | | 16.00% | |

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).