WEEKLY COMMENTARY

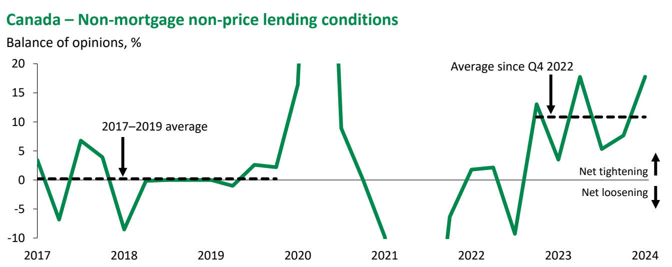
Don't Expect Miracles from Rate Cuts

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

Many are pinning their hopes for Canada's economic outlook on the recently initiated rate-cutting cycle. With the Bank of Canada lowering interest rates twice already this year and signalling more cuts to come, it's only natural to expect the Canadian economy to start coming to life. But a look at the consumer credit cycle should give us pause.

Household lending conditions have been tightening steadily for over a year. According to the Bank of Canada's latest Senior Loan Officer Survey, financial institutions started tightening their non-mortgage lending conditions in Q4 2022 and continued making lending criteria more strict in four of the last five quarters in the survey. This manifests not only in borrowing costs that have gone up, but also in non-price lending conditions, which have tightened over the past six quarters (graph 1). We've never seen such a long tightening streak outside the pandemic.

Graph 1
Consumer Credit Isn't Easy to Get Anymore



Bank of Canada and Desjardins Economic Studies

The underlying reasons behind this tightening suggest it won't end anytime soon. Lenders are reporting an increase in delinquencies. According to Equifax, the number of consumers who were delinquent on at least one credit payment in the first quarter was up 12.2% year-over-year. Meanwhile average credit scores are falling, especially for tenants, who are facing significant rent increases. And the share of credit card holders paying their monthly balance in full is down from last year. There's been a lot of talk about the payment shock for mortgage borrowers, but we tend to forget that consumers who suddenly carry a credit card balance now face exorbitant interest charges, raising the risk of default. In response to these trends, lenders are tightening their lending requirements on new loans to manage their overall loan portfolio risk. This is a common phenomenon and reflects the interplay between the credit and economic cycles.

Household fundamentals will only make lenders more conservative going forward. By its very nature, the labour market plays a key role in lending decisions, and employment has fallen for two straight months in Canada. Meanwhile unemployment is up 1.6 percentage points from its low. It held steady in July, but only because the labour force participation rate declined, suggesting that some job seekers are discouraged. Statistics Canada's broader measure of underemployment, which includes individuals who aren't working because they're discouraged, has been rising faster than the unemployment rate since early 2023 (graph 2 on page 2). It remains to be seen how much lenders will differentiate between higher unemployment due to job losses, like we see during recessions, and higher unemployment due to a rapidly expanding workforce, like we're seeing now. This is why incomes are not currently collapsing. But

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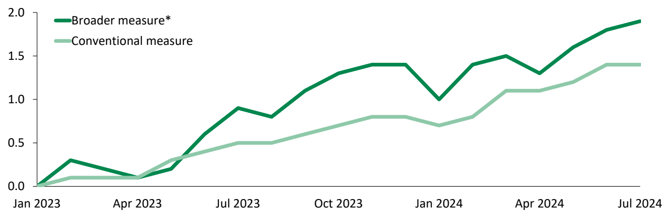
Graph 2
The Softening Labour Market Doesn't Bode Well for Credit Conditions

Unemployment and underemployment measures
% points since January 2023

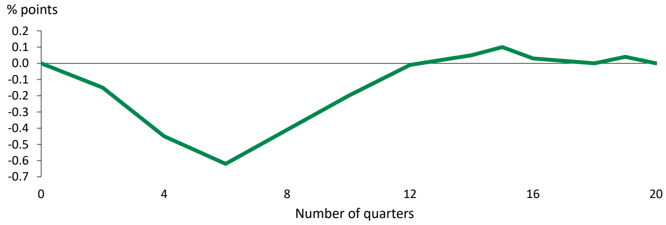


* Measure R8 (seasonally adjusted), which includes discouraged job seekers, involuntary part-time workers and those waiting for a job to begin.
Statistics Canada and Desjardins Economic Studies

weak growth in inflation-adjusted disposable income over the past three years (0.9% per year on average) is still worrying.

Much of the excitement around lower interest rates rests on the notion that borrowing costs will fall, encouraging spending. But retail interest rates won't necessarily come down overnight or automatically. Furthermore, underlying this view is the assumption that credit will flow freely, which is rather optimistic given what we've already discussed. According to research by the Federal Reserve Bank of New York, it takes six quarters to see the full impact of a credit crunch on growth (graph 3).

Graph 3
It Takes a Year and a Half Before the Growth Drag From a Credit Supply Shock Begins to Dissipate
United States – Estimated impact of a credit supply shock on GDP growth
% points



Federal Reserve Bank of New York and Desjardins Economic Studies

This is a reminder of the obstacles that remain, and that it will take many rate cuts before we see a lasting impact. Household finances stretched thin by rising housing costs will likely cause financial stress for many consumers and prompt lenders to be more cautious. To what extent? It all depends on the job market. If labour market weakness continues to be concentrated largely among young people and newcomers, the impacts will be limited and lenders probably won't severely restrict credit across the board. But if that weakness spreads to people in their prime working years (25 to 54), who are more likely to have considerable financial obligations, the effect on credit conditions could be more dramatic. However, this would be more in line with a hard landing, which isn't our current base case scenario.

That said, the presence of these risks should give some perspective on the nine rate cuts we're expecting from the Bank of Canada by the end of 2025.[1] It is by no means an aggressive rate path—just a return to neutral in about a year. If we start to see a more pronounced credit crunch, the Bank will have to pick up the pace of rate cuts if it wants to pull off the soft landing. This is why its recently renewed focus on job market signals makes a lot of sense.

[1] Our next Economic & Financial Outlook will be released on August 22.

What to Watch For

UNITED STATES

MONDAY August 19 - 10:00

July	m/m
Consensus	-0.3%
Desjardins	-0.5%
June	**-0.2%**

Leading indicator (July) – The leading indicator shed 0.2% in June, which was an improvement on the deeper losses in April and May. But we expect it to have fallen by 0.5% in July due to negative contributions from hours worked, consumer confidence, building permits, the ISM index and the interest rate spread. The stock market was probably the only component to make a significant positive contribution.

THURSDAY August 22 - 10:00

July	ann. rate
Consensus	3,900,000
Desjardins	3,960,000
June	**3,890,000**

Existing home sales (July) – Home resales have been trending downward since the end of winter. They've fallen for four straight months (March to June), contracting by a total of 11.2%. This pullback was observed in single-family homes (-11.1%) and condos (-9.8%), both of which saw increases in the number of properties for sale. But existing home sales likely went back up in July. This is what we've concluded based on the 4.8% jump in pending sales for June. Regional data published so far also paints a sunnier picture than in previous months.

THURSDAY August 22 - 10:00

July	ann. rate
Consensus	631,000
Desjardins	615,000
June	**617,000**

New home sales (July) – After plummeting by 14.9% in May, new single-family home sales continued to slide in June, although by a much more modest 0.6%. Annualized sales came in at 617,000, the lowest since November 2023. Sales probably flatlined in July, as signalled by the number of building permits for single-family homes issued in July and the stabilization of the home builder confidence index. But the exceptionally high volatility of sales and frequent revisions to previous data make forecasting difficult. That said, mortgage rates have clearly dropped in recent weeks, which should boost property sales over the next few months.

CANADA

TUESDAY August 20 - 8:30

July	m/m
Consensus	0.4%
Desjardins	0.4%
June	**-0.1%**

Consumer price index (July) – Headline consumer price growth likely decelerated two ticks to 2.5% on an annual basis. Excluding food and energy, core inflation is also expected to have moderated to 2.6%, the slowest pace since mid-2021. With the share of CPI components growing faster than 3% normalizing, Canadian central bankers are feeling more comfortable that inflation is stabilizing within their target range. That said, central bankers will want more signs that their preferred core inflation measures are moving lower.

FRIDAY August 23 - 8:30

June	m/m
Consensus	-0.3%
Desjardins	-0.2%
May	**-0.8%**

Retail sales (June) – We anticipate that retail sales edged down by 0.2% in June, just one tick less than Statistics Canada's flash estimate of -0.3%. Lower gas prices are expected to have dragged down nominal sales at gasoline stations. This may have been partially offset by core sales—which exclude autos and gasoline—which probably stayed stable month-over-month. Nominal sales of motor vehicles and parts likely inched down due to lower prices. For July's flash estimate, retail sales probably increased, with growth in auto and core sales likely compensating for declining gasoline sales.

THURSDAY August 22 - 4:00

August	
Consensus	50.1
July	**50.2**

OVERSEAS

Eurozone: PMI (August – preliminary) – The Eurozone Composite PMI has been retreating since the spring, receding from a 2024 high of 52.2 in May to 50.9 in June and 50.2 in July. Another slide this month could take the index below the 50-point threshold. This would be a sign that the eurozone's economy is struggling after posting a 0.3% uptick in non-annualized real GDP for the second quarter. However, an increase in the index would suggest that economic growth has taken root in the eurozone and could last for some time.

Economic Indicators

Week of August 19 to 23, 2024

Date	Time	Indicator	Period	Consensus		Previous reading
UNITED STATES						
MONDAY 19	9:15	Speech by Federal Reserve Governor C. Waller				
	10:00	Leading indicator (m/m)	July	-0.3%	-0.5%	-0.2%
TUESDAY 20	13:35	Speech by Federal Reserve Bank of Atlanta President R. Bostic				
	14:45	Speech by Federal Reserve Vice Chair M. Barr				
WEDNESDAY 21	14:00	Release of the Federal Reserve's meeting minutes				
THURSDAY 22	8:30	Initial unemployment claims	Aug. 12–16	n/a	225,000	227,000
	10:00	Existing home sales (ann. rate)	July	3,900,000	3,960,000	3,890,000
FRIDAY 23	10:00	New home sales (ann. rate)	July	631,000	615,000	617,000
	10:00	Speech by Federal Reserve Chair J. Powell				
CANADA						
MONDAY 19	10:30	Release of the Bank of Canada's Senior Loan Officer Survey				
TUESDAY 20	8:30	Consumer price index				
		Total (m/m)	July	0.4%	0.4%	-0.1%
		Total (y/y)	July	2.5%	2.5%	2.7%
WEDNESDAY 21	8:30	Industrial product price index (m/m)	July	n/a	0.1%	0.0%
	8:30	Raw materials price index (m/m)	July	n/a	0.1%	-1.4%
THURSDAY 22	---	---				
FRIDAY 23	8:30	Retail sales				
		Total (m/m)	June	-0.3%	-0.2%	-0.8%
		Excluding automobiles (m/m)	June	-0.3%	-0.2%	-1.3%

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 August 19 to 23, 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 19							
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TUESDAY 20							
Germany	2:00	Producer price index	July	0.2%	-0.8%	0.2%	-1.6%
Sweden	3:30	Bank of Sweden meeting	Aug.	3.50%		3.75%	
Eurozone	4:00	Current account (€B)	June	n/a		36.7	
Italy	4:30	Current account (€M)	June	n/a		2,078	
Eurozone	5:00	Construction	June	n/a	n/a	-0.9%	-2.4%
Eurozone	5:00	Consumer price index – final	July	0.0%	2.6%	0.0%	2.5%
Japan	19:50	Trade balance (¥B)	July	-753.5		-816.8	
WEDNESDAY 21							
South Korea	---	Bank of Korea meeting	Aug.	3.50%		3.50%	
Japan	20:30	Composite PMI – preliminary	Aug.	n/a		52.5	
Japan	20:30	Manufacturing PMI – preliminary	Aug.	n/a		49.1	
Japan	20:30	Services PMI – preliminary	Aug.	n/a		53.7	
THURSDAY 22							
France	3:15	Composite PMI – preliminary	Aug.	49.0		49.1	
France	3:15	Manufacturing PMI – preliminary	Aug.	44.2		44.0	
France	3:15	Services PMI – preliminary	Aug.	50.3		50.1	
Germany	3:30	Composite PMI – preliminary	Aug.	49.3		49.1	
Germany	3:30	Manufacturing PMI – preliminary	Aug.	43.5		43.2	
Germany	3:30	Services PMI – preliminary	Aug.	52.3		52.5	
Eurozone	4:00	Composite PMI – preliminary	Aug.	50.1		50.2	
Eurozone	4:00	Manufacturing PMI – preliminary	Aug.	45.8		45.8	
Eurozone	4:00	Services PMI – preliminary	Aug.	51.7		51.9	
United Kingdom	4:30	Composite PMI – preliminary	Aug.	52.9		52.8	
United Kingdom	4:30	Manufacturing PMI – preliminary	Aug.	52.1		52.1	
United Kingdom	4:30	Services PMI – preliminary	Aug.	52.8		52.5	
Eurozone	10:00	Consumer confidence – preliminary	Aug.	-12.8		-13.0	
United Kingdom	19:01	Consumer confidence	Aug.	-12		-13	
Japan	19:30	Consumer price index	July		2.7%		2.8%
FRIDAY 23							
France	2:45	Business confidence	Aug.	96		94	
France	2:45	Production outlook	Aug.	-16		-18	

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).