DESJARDINS LEADING INDEX

The Desjardins Leading Index (DLI) is a composite index that allows market players to monitor shifts in Quebec's economy that may indicate an imminent slowdown, recession or recovery in the next six months or so.

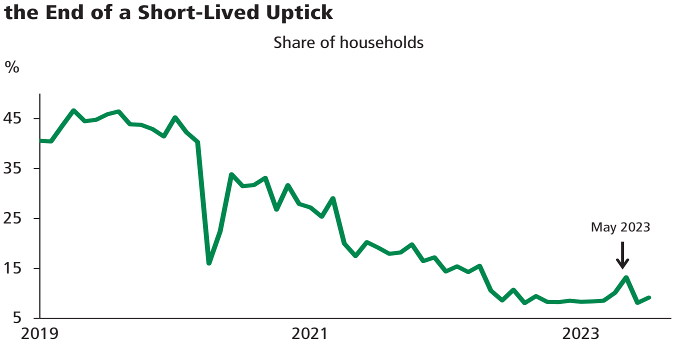
The DLI Enters Positive Territory, but Quebec Isn't Quite Ripe for a Rebound

By Hélène Bégin, Principal Economist

May saw the DLI rise 0.7% after more than a year of declines. While that's ostensibly encouraging, most economic indicators are still much too weak to expect economic conditions in Quebec to improve anytime soon. Plus, June and July's rate hikes from the Bank of Canada (BoC) mean there's no relief in sight for consumers and businesses, which are already showing signs of stress. Add to that the natural disasters such as forest fires and floods that have been plaguing different parts of the province since spring and that are set to continue to disrupt the economy and people's lives.

The first of the DLI's three components, households, saw a marked improvement in May. Consumers were temporarily reassured by the pause in the BoC's rate hikes, suggesting the cycle had come to its end. But then came the cold shower of two further 25 basis point increases in June and July, causing the share of households that think it's a good time to make a major purchase to plummet (graph).

GRAPH
Good Time to Make a Major Purchase in Quebec: May 2023 Marks the End of a Short-Lived Uptick



Sources: Conference Board of Canada and Desjardins Economic Studies

May's improvement in the DLI's household component is unlikely to last. On top of the fresh rate hikes, more recent developments will also affect results. Retail sales have been showing signs of weakness and employment has been up and down over the past several months. While June's 4.4% unemployment rate remains low, it's been slowly creeping up from its trough of 3.9%. And although Quebec's inflation rate slowed to 3.6% in June, it's still well above the nationwide rate of 2.8%. All in all, a number of barriers to consumer spending are set to remain, keeping it down over the coming months.

It's the same story in residential real estate. Sales and average home prices picked up slightly after the slump seen between the second quarter of 2022 and the beginning of 2023. But it's likely to be short-lived given June's flat numbers in Quebec. Between the dampening effects of higher interest rates and the impending labour market deterioration, we should soon see a second wave of price corrections in the resale market. Although building permits for residential construction did rebound in May, figures have been in very negative territory since the start of the year. The same is true for housing starts, which fell roughly 40% over the first six months of the year compared to the same period in 2022. All of that suggests May's rebound in the housing component will be fleeting.

The DLI's business component remained negative in May. The decline in the international trade index is already showing up in Quebec's international exports, which have been falling since the start of the year. Although SME confidence has been on the rise in recent months, it's still at a near record low. Plus, skyrocketing costs over the past few years and rising interest rates have put businesses on shaky financial footing.

IMPLICATIONS

For a number of reasons, there isn't a solid foundation underlying May's DLI rebound. As we discussed in a recent note, we expect economic activity to contract in the coming quarters. With multiple cracks already showing in Quebec's economy, it's only a matter of time before interest rate hikes and the looming softening of the labour market take their toll. The effects of natural disasters will add further strain.