WEEKLY COMMENTARY

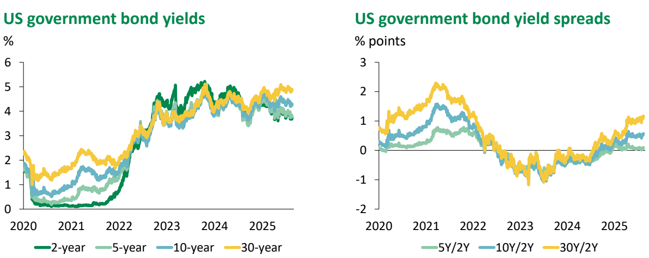
The Best Laid Fiscal Plans of Mice and Men Often Go Awry

By Randall Bartlett, Deputy Chief Economist

One of the more interesting aspects of spending two weeks of every summer in the Canadian wilderness is seeing what's changed and what hasn't when you return to civilization. Erratic trade policy, questionable Federal Reserve appointments and federal government firings continued to erode the economic credibility of the US administration. US and Canadian central banks kept rates unchanged, as expected. And equity markets seemingly took it all in stride, rallying to new heights.

Where the US administration's misguided economic policies and attacks on monetary policy and statistical independence have instead been reflected is in the bond market. Longer-term US government bond yields remain elevated, boosted by planned larger deficits and higher debt along with still-lofty inflation expectations south of the border (graph 1). Meanwhile, shorter-term bond yields have fallen on the expectation of future rate cuts. We expect the Federal Reserve to cut interest rates in September, with markets pricing in more than two full cuts by year-end. The resulting steepening of the US yield curve means newly issued longer-term debt will become more costly to service than shorter-term debt, possibly incentivizing the US administration to favour Treasury bills over bonds. But while this may benefit the administration in the near term, it could be more costly in the long run in the unlikely event that the Fed is forced to ultimately hike rates to combat tariff- and deficit-induced inflation. This is already a concern, as US government debt has a shorter average term to maturity than the government debt of most other OECD countries, including Canada.

Graph 1
US Yield Spreads Are Widening as Long-Term Interest Rates Stay High



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While notable in the United States for all the wrong reasons, a steepening yield curve isn't just a US problem. Yield curves have steepened in other major advanced economies as well, Canada among them. The spread between 10-year and 2-year Government of Canada (GoC) bond yields is now the largest it's been since the Bank of Canada's policy rate lifted off rock-bottom levels in early 2022. The same is true for the spread between 5-year and 2-year bond yields. Meanwhile, 30-year bond yields recently hit their highest level in 15 years—a particularly acute risk for provincial governments who are the primary issuers at this longer-term maturity. Our Macro Strategy team has determined that much of the recent run-up in long-term GoC bond yields reflects global factors, with the higher term premium imported largely from the United States. And they expect this trend toward a steeper yield curve in Canada, the US and further afield to persist going forward (graph 2 on page 2).

What does this mean for the Government of Canada's fiscal position? Considering the federal government has been actively cutting taxes (excluding tariffs) and announcing massive new

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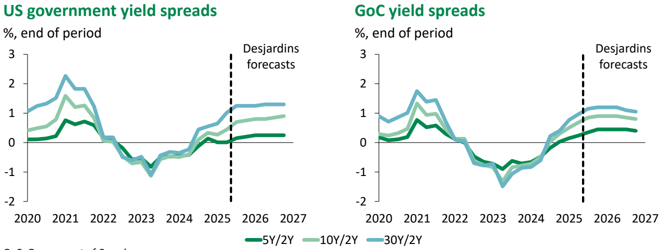
Graph 2
Yield Curves in the US and Canada Risk Steepening Further



GoC: Government of Canada
NOTE: 5Y/2Y refers to the spread between 5-year and 2-year interest rates on government bonds. 10Y/2Y and 30Y/2Y are similarly defined.
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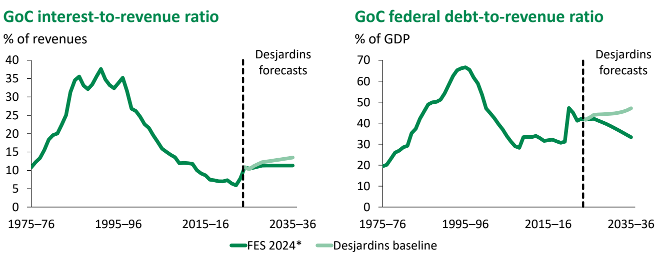
spending measures, particularly on defence, deficits were expected to be large even if interest rates remain relatively contained. And that assumes recently announced spending cuts are achieved. If the Government of Canada's yield curve steepens further, the federal government could find itself in a position where public debt charges start eating up an ever-increasing share of revenues (graph 3). While not expected to be anything close to the vicious spiral that characterized federal finances in the 1980s when interest rates hit double digits, a steepening yield curve poses a risk to fiscal sustainability that is largely beyond the control of the federal government. But the same is true for other countries, including advanced economies similarly ramping up defence spending but from a worse fiscal starting point. As such, unless long-term borrowing costs rise especially aggressively or are accompanied by a sharp slowing in the Canadian economy, our research suggests a steeper yield curve may not be enough on its own to cause a downgrade of Government of Canada debt.

Graph 3
A Steepening Yield Curve Poses an Upside Risk to Federal Finances



GoC: Government of Canada; FES: Fall Economic Statement
* Forecasts after the 2028–29 fiscal year are based on Desjardins assumptions.
GoC, Statistics Canada and Desjardins Economic Studies

Although not an imminent risk to federal fiscal sustainability, rising long-term interest rates risk raising borrowing costs for the Government of Canada. Ultimately, the GoC could be left with no choice but to raise taxes and/or forego planned spending to ensure federal debt obligations can be met. Indeed, to borrow from an old proverb, "the best laid fiscal plans of mice and men often go awry."

What to Watch For

UNITED STATES

TUESDAY August 19 - 8:30

July	ann. rate
Consensus	1,290,000
Desjardins	1,300,000
June	**1,321,000**

Housing starts (July) – After plunging in May to their lowest level since the early months of the 2020 pandemic, housing starts surged 4.6% in June. However, despite the rebound, the June reading was still relatively low, and we expect housing starts renewed their decline in July. They were likely held back by several factors, including the June drop-off in building permits, the recent slump in new home sales, widespread heat waves, the July contraction in residential construction payrolls and persistent labour challenges linked to the Trump administration's immigration policy. We expect a decrease to 1,300,000 units.

THURSDAY August 21 - 10:00

July	m/m
Consensus	-0.1%
Desjardins	-0.1%
June	**-0.3%**

Leading indicator (July) – After flatlining in May, the leading indicator resumed its downward trend in June with a 0.3% decline. We forecast a less pronounced drop of around 0.1% in July. The ISM index, consumer confidence and building permits likely exerted the strongest downward pressure on the indicator, though gains in the stock market and a decline in unemployment claims may have partly mitigated their impact.

THURSDAY August 21 - 10:00

July	ann. rate
Consensus	3,900,000
Desjardins	3,910,000
June	**3,930,000**

Existing home sales (July) – Existing home sales cooled 2.7% month over month in June, and we're expecting another pullback in July. But the decrease shouldn't be as marked, since pending sales and preliminary regional data posted modest contractions. We expect existing home sales fell to 3,910,000 units.

CANADA

MONDAY August 18 - 8:15

July	ann. rate
Consensus	272,500
Desjardins	265,000
June	**283,700**

Housing starts (July) – We expect housing starts eased to about 265k (saar) in July after three outsized months that beat the consensus of economic forecasters. Recent strength in homebuilding seems unsustainable in an environment of rising residential construction inflation, the ongoing trade war, upwardly trending completed and unabsorbed condo units and weak presales in key markets.

TUESDAY August 19 - 8:30

July	m/m
Consensus	0.4%
Desjardins	0.2%
June	**0.1%**

Consumer price index (July) – Headline consumer price growth likely accelerated last month to 0.2% from 0.1% the prior month. This would cause the annual rate to fall to 1.6% from 1.9% in June due to base effects. We expect lower energy prices during the month to have partially offset our forecast for a moderate rise in prices excluding food and energy. The jury is still out on whether companies will pass on tariff-related costs to consumers. Core goods prices have risen, suggesting some passthrough, but most of the increase has been concentrated in automobile prices. For July, we'll be looking to see if those price increases continued or broadened out. Services inflation likely continued to moderate as shelter prices normalized further. While the Bank of Canada's core measures of inflation probably drifted slightly higher, most of that increase is due to inflation readings earlier in the year. We expect the three-month annualized rates of the Bank of Canada's core measures to have fallen notably in July.

FRIDAY August 22 - 8:30	
June	**m/m**
Consensus	1.1%
Desjardins	1.5%
May	**-1.1%**

Retail sales (June) – Retail sales probably rose by 1.5% in June, slightly below Statistics Canada's flash estimate. After a decline in the prior month, we expect a reversal of fortunes in June. Receipts at gasoline stations probably increased thanks to a rise in purchase volumes despite a month of lower pump prices compared to May. This was likely at least partially driven by increased domestic travel as the number of Canadian tourists visiting the United States fell. Core retail sales, which exclude autos and gasoline, may have seen a strong increase in the month on a likely combination of higher prices and purchases in June. We anticipate a decline in sales at motor vehicle and parts dealerships thanks to a significant decline in volumes and, to a lesser extent, prices. For the July flash estimate, we estimate retail sales to be broadly flat, likely motivated by higher auto sales offset by slowing momentum in gasoline prices.

OVERSEAS

THURSDAY August 21 - 4:00	
August	
Consensus	50.6
July	**50.9**

Eurozone: PMI index (August – preliminary) – The latest data from July suggested that although the economy showed signs of stabilization, it was struggling to generate robust growth. The composite index improved slightly from 50.6 in June to 50.9 in July, but the manufacturing sector—which is still contracting, albeit at a slower pace—and the gradually expanding services sector continue to diverge. This trend is expected to continue in August. New orders and price pressures will be closely watched, as they will be crucial indicators for the European Central Bank's policy trajectory for the rest of the year. Another sub-50 reading for manufacturing would confirm the persistent weakness of the eurozone's industrial sector.

Economic Indicators

Week of August 18 to 22, 2025

Date	Time	Indicator	Period	Consensus	Desjardins	Previous reading
UNITED STATES						
MONDAY 18	10:00	NAHB Housing Market Index	Aug.	34	n/a	33
TUESDAY 19	8:30	Housing starts (ann. rate)	July	1,290,000	1,300,000	1,321,000
	8:30	Building permits (ann. rate)	July	1,390,000	1,360,000	1,393,000
	14:10	Speech by Federal Reserve Governor M. Bowman				
WEDNESDAY 20	11:00	Speech by Federal Reserve Governor C. Waller				
	14:00	Release of the Federal Reserve's meeting minutes				
	15:00	Speech by Federal Reserve Bank of Atlanta President R. Bostic				
THURSDAY 21	8:30	Initial unemployment claims	Aug. 11–15	n/a	227,000	224,000
	8:30	Philadelphia Fed index	Aug.	8.0	9.0	15.9
	10:00	Leading indicator (m/m)	July	-0.1%	-0.1%	-0.3%
	10:00	Existing home sales (ann. rate)	July	3,900,000	3,910,000	3,930,000
FRIDAY 22	10:00	Speech by Federal Reserve Chair J. Powell				
CANADA						
MONDAY 18	8:15	Housing starts (ann. rate)	July	272,500	265,000	283,700
	8:30	International securities transactions ($B)	June	n/a	n/a	-2.79
TUESDAY 19	8:30	Consumer price index				
		Total (m/m)	July	0.4%	0.2%	0.1%
		Total (y/y)	July	1.8%	1.6%	1.9%
WEDNESDAY 20	---	---				
THURSDAY 21	8:30	Industrial product price index (m/m)	July	n/a	0.4%	0.4%
	8:30	Raw materials price index (m/m)	July	n/a	0.9%	2.7%
FRIDAY 22	8:30	Retail sales				
		Total (m/m)	June	1.1%	1.5%	-1.1%
		Excluding automobiles (m/m)	June	0.9%	2.7%	-0.2%
	10:30	Release of the Bank of Canada's Senior Loan Officer Survey				

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 18 to 22, 2025

Country	Time	Indicator	Period	Consensus m/m (q/q)	Consensus y/y	Previous reading m/m (q/q)	Previous reading y/y
OVERSEAS							
MONDAY 18							
Japan	0:30	Tertiary Industry Activity Index	June	0.2%		0.6%	
Eurozone	5:00	Trade balance (€B)	June	n/a		16.2	
TUESDAY 19							
Eurozone	4:00	Current account (€B)	June	n/a		32.3	
Italy	4:30	Current account (€M)	June	n/a		1,665	
Japan	19:50	Trade balance (¥B)	July	-81.4		-235.5	
New Zealand	22:00	Reserve Bank of New Zealand meeting	Aug.	3.00%		3.25%	
WEDNESDAY 20							
United Kingdom	2:00	Consumer price index	July	0.0%	3.7%	0.3%	3.6%
Germany	2:00	Producer price index	July	0.1%	-1.3%	0.1%	-1.3%
Norway	3:30	Bank of Norway meeting	Aug.	2.00%		2.00%	
Eurozone	5:00	Consumer price index – final	July	0.0%	2.0%	0.0%	2.0%
Japan	20:30	Composite PMI – preliminary	Aug.	n/a		51.6	
Japan	20:30	Manufacturing PMI – preliminary	Aug.	n/a		48.9	
Japan	20:30	Services PMI – preliminary	Aug.	n/a		53.6	
THURSDAY 21							
France	3:15	Composite PMI – preliminary	Aug.	48.8		48.6	
France	3:15	Manufacturing PMI – preliminary	Aug.	48.3		48.2	
France	3:15	Services PMI – preliminary	Aug.	48.6		48.5	
Germany	3:30	Composite PMI – preliminary	Aug.	50.4		50.6	
Germany	3:30	Manufacturing PMI – preliminary	Aug.	48.9		49.1	
Germany	3:30	Services PMI – preliminary	Aug.	50.7		50.6	
Eurozone	4:00	Composite PMI – preliminary	Aug.	50.6		50.9	
Eurozone	4:00	Manufacturing PMI – preliminary	Aug.	49.5		49.8	
Eurozone	4:00	Services PMI – preliminary	Aug.	50.8		51.0	
United Kingdom	4:30	Composite PMI – preliminary	Aug.	51.7		51.5	
United Kingdom	4:30	Manufacturing PMI – preliminary	Aug.	48.3		48.0	
United Kingdom	4:30	Services PMI – preliminary	Aug.	52.0		51.8	
Eurozone	5:00	Construction	June	n/a	n/a	-1.7%	2.9%
Eurozone	10:00	Consumer confidence – preliminary	Aug.	-14.9		-14.7	
United Kingdom	19:01	Consumer confidence	Aug.	-19		-19	
Japan	19:30	Consumer price index	July		3.1%		3.3%
FRIDAY 22							
United Kingdom	2:00	Retail sales	July	0.5%	1.3%	0.9%	1.7%
Germany	2:00	Real GDP – final	Q2	-0.1%	0.4%	-0.1%	0.4%
France	2:45	Business confidence	Aug.	97		96	
France	2:45	Production outlook	Aug.	n/a		-12	

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. 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).