WEEKLY COMMENTARY

The Goldilocks Goal

By Royce Mendes, Managing Director and Head of Macro Strategy

Much like Goldilocks searching for just the right porridge, the Bank of Canada is searching for just the right monetary policy setting: not too easy and not too restrictive. The problem is that Bank officials have conflicting readings on the temperature of the economy. The labour market keeps churning out jobs, and workers are expecting that to translate into heady pay raises. Complicating the matter, consumers also expect inflation to remain elevated. Conversely, businesses have soured on the economic outlook and plan to restrain employee compensation growth.

So what's a central banker to do? Talk tough but refrain from making any hasty decisions. Past rate hikes are still working their way through the economy. One thing both businesses and consumers agree on is that the impact of rate hikes is just beginning to be felt. The Bank of Canada's own heuristic that rate hikes take between 18 and 24 months to be fully reflected in economic activity suggests the same thing. With that in mind, another rate hike could very well be overkill. But bear in mind that, while central bankers haven't touched the policy rate since July, 10-year bond yields are roughly 70 basis points higher. Globally, investors are requiring more compensation to hold even the safest bonds.

Make no mistake, the recent rise in bond yields is indeed a substitute for a rate hike. So while data on businesses and households has been mixed, there's little question that financial conditions have tightened enough to offset any unanticipated strength in the economy. In fact, the Bank of Canada will likely need to slash its GDP projections. And even though it will have to revise its inflation estimate higher for this year, that's largely the result of energy prices and a weaker exchange rate—two drivers central bankers tend to look through.

That said, while the work of an additional rate hike has been done by rising bond yields, don't expect Governor Macklem to wave the white flag next week. Policymakers don't want to see the market price in rate cuts again in early 2024. He'll need to sound sufficiently hawkish to retain current market pricing, which more or less has the Bank of Canada holding rates steady until 2025. But the reality is that policymakers must know that would be an unlikely outcome. With between 1% and 1.5% of mortgages renewing each month in this higher interest rate environment, the economy will feel much more pain next year than currently, making it difficult to maintain this level of interest rates.

Moreover, the economic destruction in 2024 might look somewhat contained relative to what could happen in 2025 and 2026 if forward market rates are realized. Many mortgage holders will renew in 2025 and 2026 at higher interest rates than the rock-bottom levels they locked in at five years earlier. The question is how much higher. Should central bankers truly want to avoid cooling the economy too much, they'll need to reduce interest rates before hitting that wall of renewals.

Trimming interest rates in 2024 will, of course, require that inflation cooperates with monetary officials. The good news is that the latest reading on consumer prices showed an unanticipated slowdown. While there's much further to go to achieve the 2% target, each step along the way represents necessary progress. As a result, we believe that a return to price stability is now in sight. So if central bankers are truly committed to the Goldilocks outcome, they'll hold off on raising rates any further while they let past hikes work. Eventually, the Goldilocks goal should also allow them to begin trimming rates in 2024.

CONTENT

Desjardins Economic Studies: 514-281-2336 or 1-866-866-7000, ext. 5552336 • desjardins.economics@desjardins.com • desjardins.com/economics

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

WEDNESDAY October 25 - 10:00

September	ann. rate
Consensus	683,000
Desjardins	675,000
August	**675,000**

New home sales (September) – New home sales have been volatile in recent months after a fairly positive period between late 2022 and spring 2023. After rising 8.0% in July, sales plummeted 8.7% in August. We think September's print will be flat. August's plunge makes a rebound more likely, and building permits for single-family homes also posted a relatively strong gain last month. However, mortgage applications for home purchases remain very low due to further increases in mortgage rates. Builder confidence—especially the Present Single-Family Sales component of the NAHB Housing Market Index—fell. All in all, we expect sales to remain flat at 675,000 units.

THURSDAY October 26 - 8:30

Q3 1st est.	ann. rate
Consensus	4.4%
Desjardins	5.0%
Q2	**2.1%**

Real GDP (third quarter – first estimate) – Real GDP growth was fairly stable in the first half of 2023, with annualized gains of 2.2% and 2.1% in Q1 and Q2, respectively. We're expecting a sharp rebound in the third-quarter print, mainly on the back of much stronger real consumer spending—we're forecasting over 4%—than the spring's pitiful 0.8% annualized figure. However, we're anticipating a more modest increase in business investment and another dip in residential construction. Inventory accumulation and net exports should also contribute positively. We're projecting annualized real GDP growth of 5.0% for the third quarter. September's data on income, consumer spending and the Personal Consumption Expenditures price index, which will be released on Friday, will also be an interesting read.

THURSDAY October 26 - 8:30

September	m/m
Consensus	1.4%
Desjardins	2.9%
August	**0.1%**

Durable goods orders (September) – After plunging 5.6% in July, durable goods orders edged up just 0.1% in August. We're expecting a much better print for September. The biggest contribution will be from the nondefense aircraft sector, after Boeing's order book fattened considerably last month. The situation in the automotive sector is more mixed. Industrial production rose despite the strikes at some of the big three US carmakers' factories. Orders should increase slightly, although impact of the strikes is particularly uncertain. Excluding transportation, durable goods orders likely gained 0.3%, which is close to the average over the previous months. We're anticipating a 2.9% jump in durable goods orders overall.

CANADA

WEDNESDAY October 25 - 10:00

October	
Consensus	5.00%
Desjardins	5.00%
September 6	**5.00%**

Bank of Canada (October) – The Bank of Canada is expected to keep rates unchanged next week as it waits for the effects of past rate hikes to work their way through the economy. Other than the employment numbers, economic data has for the most part continued to come in weaker than the Bank of Canada expected. While inflation has moved off its lows from earlier this year, the latest reading showed some progress towards price stability. That should reassure central bankers that their monetary medicine is working. With a boost from the recent rise in global long-term government bond yields, Canadian financial conditions are tighter since the last Monetary Policy Report. That said, don't expect Canadian central bankers to sound the all clear just yet. They'll likely opt to keep the door open to further rate hikes, though we believe they ultimately won't walk through it.

OVERSEAS

TUESDAY October 24 - 4:00

October	
Consensus	47.3
September	**47.2**

Eurozone: Purchasing Managers' Index (October – preliminary) – After falling for four consecutive months, the eurozone composite PMI rose slightly in September from 46.7 to 47.2. This gain was due to a modest improvement in the services index, while the manufacturing sector became further bogged down. That said, the level of the composite PMI remains consistent with a quarterly decline in eurozone real GDP. October's print will tell us whether September's rise continued into the beginning of the fourth quarter or whether the economy is likely to struggle further at the end of 2023.

THURSDAY October 26- 8:15

October	
Consensus	4.50%
Desjardins	4.50%
September 14	**4.50%**

Eurozone: European Central Bank meeting (October) – The time is probably right for a pause in the eurozone's interest rate hiking cycle. Although inflation remains high, it's clearly falling. The more fragile economic situation in the eurozone also leads us to believe that disinflationary pressure will increase over the coming quarters. That said, the European Central Bank will probably leave the door open to further interest rate hikes if needed. We'll clearly have to wait another few meetings to make sure that inflation is really on the right track before interest rate cuts become a possibility in 2024.

Economic Indicators

Week of October 23 to 27, 2023

Date	Time	Indicator	Period	Consensus		Previous reading
UNITED STATES						
MONDAY 23	---	---				
TUESDAY 24	---	---				
WEDNESDAY 25	10:00	New home sales (ann. rate)	Sept.	683,000	675,000	675,000
THURSDAY 26	8:30	Initial unemployment claims	Oct. 16–20	209,000	210,000	198,000
	8:30	Real GDP – first estimate (ann. rate)	Q3f	4.4%	5.0%	2.1%
	8:30	Durable goods orders (m/m)	Sept.	1.4%	2.9%	0.1%
	8:30	Goods trade balance – preliminary (US$B)	Sept.	-85.5	-87.0	-84.6
	8:30	Retail inventories (m/m)	Sept.	n/a	n/a	1.1%
	8:30	Wholesale inventories – preliminary (m/m)	Sept.	0.1%	n/a	-0.1%
	10:00	Pending home sales (m/m)	Sept.	-1.0%	n/a	-7.1%
FRIDAY 27	8:30	Personal income (m/m)	Sept.	0.4%	0.4%	0.4%
	8:30	Personal consumption expenditures (m/m)	Sept.	0.5%	0.6%	0.4%
	8:30	Personal consumption expenditures deflator				
		Total (m/m)	Sept.	0.3%	0.3%	0.4%
		Excluding food and energy (m/m)	Sept.	0.3%	0.2%	0.1%
		Total (y/y)	Sept.	3.4%	3.4%	3.5%
		Excluding food and energy (y/y)	Sept.	3.7%	3.7%	3.9%
	10:00	University of Michigan consumer sentiment index – final	Oct.	63.0	63.0	63.0
CANADA						
MONDAY 23	---	---				
TUESDAY 24	---	---				
WEDNESDAY 25	10:00	Bank of Canada meeting		5.00%	5.00%	5.00%
	10:00	Release of the Bank of Canada's Monetary Policy Report				
	11:00	Speech by Bank of Canada Governor T. Macklem and Senior Deputy Governor C. Rogers				
THURSDAY 26	---	---				
FRIDAY 27	---	---				

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 October 23 to 27, 2023

Country	Time	Indicator	Period	Consensus m/m (q/q)	Consensus y/y	Previous reading m/m (q/q)	Previous reading y/y
OVERSEAS							
MONDAY 23							
Eurozone	10:00	Consumer confidence – preliminary	Oct.	-18.4		-17.8	
Japan	20:30	Composite PMI – preliminary	Oct.	n/a		52.1	
Japan	20:30	Manufacturing PMI – preliminary	Oct.	n/a		48.5	
Japan	20:30	Services PMI – preliminary	Oct.	n/a		53.8	
TUESDAY 24							
Germany	2:30	Consumer confidence	Oct.	-27.0		-26.5	
United Kingdom	2:00	ILO unemployment rate	Aug.	4.3%		4.3%	
France	3:15	Composite PMI – preliminary	Oct.	44.3		44.1	
France	3:15	Manufacturing PMI – preliminary	Oct.	44.4		44.2	
France	3:15	Services PMI – preliminary	Oct.	44.6		44.4	
Germany	3:30	Composite PMI – preliminary	Oct.	46.7		46.4	
Germany	3:30	Manufacturing PMI – preliminary	Oct.	40.1		39.6	
Germany	3:30	Services PMI – preliminary	Oct.	50.0		50.3	
Eurozone	4:00	Composite PMI – preliminary	Oct.	47.3		47.2	
Eurozone	4:00	Manufacturing PMI – preliminary	Oct.	43.7		43.4	
Eurozone	4:00	Services PMI – preliminary	Oct.	48.6		48.7	
United Kingdom	4:30	Composite PMI – preliminary	Oct.	48.7		48.5	
United Kingdom	4:30	Manufacturing PMI – preliminary	Oct.	44.7		44.3	
United Kingdom	4:30	Services PMI – preliminary	Oct.	49.3		49.3	
WEDNESDAY 25							
Japan	1:00	Leading indicator – final	Aug.	n/a		109.5	
Japan	1:00	Coincident index – final	Aug.	n/a		114.3	
Germany	4:00	ifo Business Climate Index	Oct.	85.9		85.7	
Germany	4:00	ifo Current Assessment Index	Oct.	88.5		88.7	
Germany	4:00	ifo Expectations Index	Oct.	83.5		82.9	
Eurozone	4:00	M3 money supply	Sept.		-1.8%		-1.3%
THURSDAY 26							
Eurozone	8:15	European Central Bank meeting	Oct.	4.50%		4.50%	
Japan	19:30	Tokyo Consumer Price Index	Oct.		2.7%		2.8%
FRIDAY 27							
France	2:45	Consumer confidence	Oct.	83		83	
Italy	4:00	Consumer confidence	Oct.	105.2		105.4	
Italy	4:00	Economic confidence	Oct.	n/a		104.9	
Russia	6:45	Bank of Russia meeting	Oct.	14.00%		13.00%	

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 Daylight Time (GMT - 4 hours).