LAURENTIAN BANK

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Sébastien Lavoie,
Chief Economist
LavoieS@vmbl.ca
514 350-2931

Salim Kharoubi Zanzana,
Economist
ZazanaSK@lb-securities.ca
437 219-3304

Canadian Real GDP and Bank of Canada Decision Preview –

Economic Stagnation Calls for a Pause in the Monetary Tightening Cycle

The takeaway of the very weak 2023Q2 real GDP figure and monthly readings of June and July is simple: besides disruptions caused by wildfires and the B.C. port strike, high interest rates continue to work their way through the economy, particularly weighing on consumer habits of the middle class.

Real GDP stalled in 2023Q2 relative to the previous quarter (-0.2% quarter-over-quarter, annualized). On a monthly basis, real GDP dipped by 0.2% in June relative to May. And the preliminary flash estimate of July points toward a stagnation.

Consumer spending on goods and services in volume terms was flat in 2023Q2 despite booming population growth, a sign that higher interest rates work and bite. Per-capita spending declined moderately, echoing the most recent Bank of Canada consumer survey: about half of Canadians plan to cut spending. Consumers spent less on alcohol, housing repairs, furniture, recreation, and culture during the second quarter. Clearly, households are more cautious on non-essential spending despite registering respectable growth in disposable income.

Among the key other expenditure components of real GDP, goods exports also stagnated due to weaker foreign activity. Imports advanced as companies ordered more machinery and equipment, resulting in a major drag of net exports on real GDP. In fact, business investment was the only spot of resiliency in the quarterly real GDP report. The 10% q-o-q annualized gain of 2023Q2 appears unsustainable as the outlook weakens. Also, the housing supply-demand imbalance unfortunately worsened further as new construction activity faltered to its lowest level since 2015 (down by a cumulative 15% relative to the end of 2022).

Additional signs of economic cooling were announced earlier this week. Statistics Canada's Survey of Business Conditions revealed fewer companies expect an increase in sales. Also, the percentage share of firms planning to increase prices edged down to about one-quarter, reinforcing the disinflationary trend in place. The August survey from the Canadian Federation of Independent Business showed the same story: the share of businesses indicating insufficient domestic demand climbed. And the average price increase intention slowed to 3%, breaking the 3.3%-3.7% range observed earlier this year. Furthermore, the downtrend in job vacancies continued in June according to the Survey of Employment, Payrolls and Hours (-1.2% month-over-month, -13% since the beginning of the year). This is another sign of rebalancing in labour market conditions the Bank of Canada has been looking for, in concert with the summer increase in unemployment from 5% to 5.5%.

Cracks also emerge abroad. Producer prices, a leading indicator of global consumer prices, are falling in China and Europe. Also, job postings in the U.S. are declining at a faster pace this summer than in 2008-09. Furthermore, the U.S. job report also released this Friday morning revealed a 0.3pp jump in the unemployment rate to 3.8%. This increase resulted from a large increase in the labour force, more job losers than before, and Americans who completed temporary jobs. Days of a resilient job market are over.

Bottom Line: The Canadian economy is on the verge of a mild recession, principally due to a challenging adjustment period for consumers. Combined with less favorable external developments, the wind is quickly and clearly shifting in favour of keeping the overnight rate target at its current 5.0% level. We expect the Bank of Canada to stay on the sidelines next Wednesday, September 6th. In terms of communication, it might be too soon to abandon the data-dependent policy strategy.

Sébastien Lavoie | Chief Economist
514 213-4571| LavoieS@vmbl.ca

Salim Kharoubi Zanzana | Economist
437 219-3304 | ZanzanaSK@vmbl.ca

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