Economic Commentary

Fourth Quarter 2022

Inflation Remains Elevated

Inflation remains stubbornly high, although recent data indicates that the level may have peaked and a downward trend has been established. Canadian inflation hit a post-pandemic high of 8.1% in June and then proceeded to decline modestly in the subsequent months. The annual inflation rate for November is 6.8%. In the U.S., the peak rate was 9.1% in June, with inflation now sitting at 7.1%. Despite this improving trend, inflation rates in both Canada and the U.S. remain considerably higher than the 2% target for both the Bank of Canada and the U.S. Federal Reserve. Inflation in the Eurozone did not peak until a few months later. The high print was 10.7% in October, with the most recent reading showing a rate of 10.0%. U.K. inflation hit a high of 11.1% in October before declining to 10.7% currently. Global inflation was the biggest driver of financial markets during 2022 as central banks reacted in aggressive fashion to combat the persistent trend.

Interest Rate Hikes Begins to Moderate

Aggressive interest rate hikes by global central banks was a dominant theme in 2022, particularly in North America. This trend towards higher rates continued into the fourth quarter. The Bank of Canada raised its overnight rate twice, increasing rates by 50 bp at each of its two meetings. On a year-to-date basis, the BOC raised rates by 400 bp. The U.S. Federal Reserve was slightly more aggressive, increasing its overnight rate by a combined 125 bp during the quarter and 425 bp for the year. The pace of rate hikes in the U.S., however, moderated at the December meeting. After raising rates by 75 bp on four previous occasions, the Fed increased rates by only 50 bp at its December meeting. Markets perceived this as an indication that the Fed may be close to reaching its terminal rate and that future rate hikes would be minimal.

Federal Reserve Chair Powell along with other Fed governors, however, provided projections that would indicate that interest rates would continue to rise over the near term and would remain at elevated levels longer than the market may have anticipated. This led to a back-up in bond yields into the end of the year. Both the Fed and the BOC remain resolute in their fight to bring inflation down to their 2% target over time. They are prepared to continue with aggressive monetary policy even if it puts the economy into a recession. The European Central Bank, which had not raised interest rates during the first half of the year, shifted policy and raised rates by 125 bp each in both the third and fourth quarters. The Bank of England has also been aggressive with its rate hikes, increasing its overnight rate by 125 bp during the quarter and 325 bp on a year-to-date basis.

Recessionary Fears Escalate

With global central banks embarking on aggressive monetary policy tightening campaigns during 2022, investors are becoming more nervous that the global economy will be pushed into a recession in 2023. Central banks have acknowledged that this could be a consequence of their actions, however, their goal is to reduce economic demand as well as see an increase in the unemployment rate. Their objective is to bring inflation down while negotiating a soft landing in the economy. A key sector to watch will be the labour market. So far, this sector of the economy has remained resilient, with solid monthly job gains and unemployment levels close to their post-pandemic lows. The housing sector

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Key Metrics

Indicator	Value	Chg Q4	Chg 1Y
S&P/TSX Composite	19,384.92	6.0%	-5.8%
S&P 500 (USD)	3,839.50	7.5%	-18.1%
iShares MSCI EAFE ETF (USD)	65.64	17.7%	-14.4%
USD/CAD	$ 0.74	2.0%	-6.7%
WTI Crude ($/bl))	$ 80.26	1.0%	6.7%
GoC 10Y Bond	3.30%	13 bps	187 bps
GoC Deposit Rate	4.25%	100 bps	400 bps
Cdn CPI YoY	6.8%	-0.1%	2.0%
US 10Y Treasury	3.88%	4 bps	237 bps
Fed Funds Rate	4.50%	125 bps	425 bps
USD CPI YoY	7.1%	-1.1%	0.1%

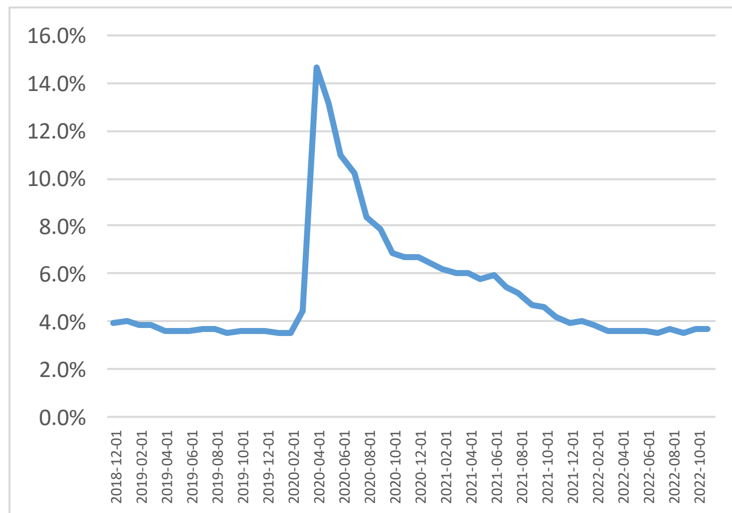
Top Themes

Despite recent drop, inflation remains stubbornly high

Aggressive pace of interest rate hikes begins to moderate

Fears over lagged impact of rate hikes will lead to recession in 2023

Top Chart: U.S. Unemployment Rate (%)



Source: Bloomberg, Lincluden

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has definitely shown signs of weakness, due to the impact of higher mortgage rates and the resulting slowdown in demand.

Equity Markets and Bond Markets Move Higher in Volatile Quarter

Financial markets continue to be volatile as there is a constant push and pull between the impact of the aggressive interest rate hikes that have been administered by global central banks and the increased probability that a recession will occur. The swiftness and magnitude of the rates hikes that were implemented in 2022 surprised many market participants and it will take time for the impact of these rate hikes to be felt throughout the economy. As a result, equity markets experienced significant declines in 2022, with the Canadian TSX lower by 8.7%. The U.S. S&P and NASDAQ indices fared much worse, with losses of 19.4% and 33.1%, respectively. Bond yields moved higher into year-end as the Federal Reserve warned investors that rate hikes will continue, and that interest rates would remain higher for a longer period of time. The yield on the benchmark 10 year U.S. Treasury bond ended the quarter at 3.88%, up 5 bp and higher by 237 bp on a year-to-date basis.