

# **2023 Economic Outlook Breakfast Meeting** Friday, January 13, 2023

An annual January event where some of Canada's leading chief economists share their economic predictions for 2023, at a breakfast in Toronto hosted by the Economic Club of Canada.

Present this year: Beata Caranci, Chief Economist, TD Bank Craig Wright, Chief Economist, RBC Douglas Porter, Chief Economist, BMO Financial Group Jean-Francois Perrault, Chief Economist, Scotiabank

The following notes are a summary of the conversation in the order that it occurred and paraphrased by Kurt Rosentreter, President, Upper Canada Capital and Senior Financial Advisor for Manulife Securities.

## ON THE CANADIAN ECONOMY RIGHT NOW...

Douglas:

- The Canadian economy had more momentum at the end of 2022 than we expected.
- A lot of "pandemic savings" means Canadians are sitting with money and there is also pent-up demand to spend.
- The Canadian economy remains strong despite higher interest rates (seven interest rate increases in Canada in 2022).
- We believe that the Canadian inflation rate will settle in at 5%.

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• We can see interest rates going higher in 2023 if the economic strength in Canada continues too much.

Jean-Francois:

- We believe the Bank of Canada could engineer a soft landing for the economy in Canada despite much higher interest rates and a cooling economy.
- We have a 3.6% inflation estimate for Canada.
- Canadian economy is proving to be robust and resilient.

Beata:

- A recession in Canada would have fewer job losses as many companies already have lean employee levels and hiring. Perhaps 100,000 job losses which is 1/3<sup>rd</sup> of normal in a recession.
- We are already at the trough of where we would see unemployment levels at.
- We see oil at \$90 a barrel with China re-opening.

Craig:

- We predicted a recession in Canada last July as tailwinds (free trade, cheap credit, low-cost labour) turns to headwinds: Free trade is now re-shoring; free money now costs 4%; carbon tax costs and labour cost is up.
- The pain is yet to come in our economy as the lag on rising interest rates eventually hits the economy. The housing market is rolling over.
- We see Canadian inflation at 1% to 3% by the end of 2023 with core inflation at 3%.
- There is a risk that the Bank of Canada goes too far in raising interest rates.

### Douglas:

• US will have 6.5% headline inflation; 6.5% to 7% inflation for 2023.

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• Hard to see them get to 2% inflation.

Jean-Francois:

- Getting close to a Bank of Canada pause on rising interest rates; might do 0.25% in January {and they did, Kurt}.
- Bank of Canada is aware of the magnitude of their decisions and may take 18-24 months to assess what to do next.

Beata:

- We see a 0.25% Bank of Canada interest rates increase in January {which is what happened, Kurt}.
- The central banks are fighting for credibility after being wrong on inflation in 2021.

Craig:

- Bank of Canada was late to start raising interest rates.
- Government over-spending during the pandemic has increased the inflation problem.

### **ON HOUSING IN CANADA...**

Douglas:

- There is a housing bubble in south-western Ontario.
- We expect prices to drop -25%.
- We are not concerned about mortgage defaults.
- There is a record 300,000 homes under development in Canada.

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Beata:

- There is strong population growth expected of 500,000 people a year concentrated in mostly five cities in Canada.
- Can only build so fast.

Jean-Francois:

- We see housing affordability getting worse in the years ahead.
- This won't change until housing supply is fixed.
- Canadians are facing a \$400 to \$700/month mortgage payment increase with higher interest rates.
- People are managing so far mortgage defaults are not up yet.
- Housing market is critical to employment numbers.

Craig:

• There are 10 million millennials to buy homes; they will be ok as long as they have jobs.

## ON THE UNITED STATES...

Beata:

- U.S. is more resilient than Canada due to less leverage. They have lower debt servicing costs.
- We expect the U.S. to outperform Canada this year. They have leaner industrial operations. Culturally, the U.S. is fast to fire people.
- We forecast 1.5M job losses in the United States.

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#### Douglas:

- For Ontario and Canada, we expect a fiscal surplus.
- For the U.S. we expect a \$1.4 trillion dollar deficit or 5% of GDP (gross domestic product).
- There is a coming debt ceiling crisis; expect government spending cuts.

### Jean-Francois:

• The U.S. has fewer economic support programs than Canada during the pandemic.

#### Craig:

- We see Canada outperforming the U.S. in 2023 GDP.
- The U.S. has a lower savings rate; Canada has more growth potential including a lift from Alberta.

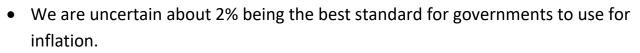
### ON THE WORLD AND IN GENERAL...

Douglas:

- We are optimistic about China's re-opening but worried about geo-political risk in China, Iran, North Korea and Russia.
- We are not bullish on commodities in a slowing economy.
- U.S. had 7% inflation before the war.
- We see a lower Canadian dollar due to a stronger U.S. dollar. 75 cents is fair value in our estimation.
- U.S. dollar will fall as interest rate hikes stop.
- Euro strengthened against the Canadian dollar during 2022. Canadian dollar is weaker due to lower commodity prices.

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 There is a policy induced slowdown going on where governments know what to do. We could see a "Goldilocks" result with higher interest rates but no recession.

#### Craig:

- International Monetary Fund has global growth at 1.5% and China at 4.4% in 2023; that is a downward trend.
- Ukraine war creates a lot of geo-political uncertainty.

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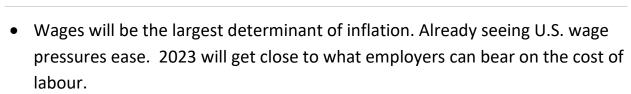
- Sector specific taxation in Canada is bad policy. Uncertain about carbon pricing.
- We need to rebrand Canada as open for global market investment.
- Canada is too focused on short term solutions we need to up our game on global capital flows and increase our productivity.
- Consumers have a war-chest of savings in place. Spending continues which leads to growth.
- There will be a rough spring housing market.

#### Beata:

- We have oil at \$90/barrel, up from \$75/barrel now.
- Surging U.S. exports in liquified natural gas (LNG).
- Europe is evolving.
- Lost the "kumbaya" moment in globalization. Global, integrated supply chains concentration risk to countries.

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- Cost of shelter is a lag on inflation in the U.S. which is in the turn on inflation.
- Canada relies on people instead of processes (e.g., international nurses) our problems are not fixed by immigration. We have fewer doctor residency spots in Canada today than in the 80s.
- We are bracing for a recession.

Jean-Francois:

• The impact of the war in Ukraine depends on where you are:

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- Europe will have a recession in 2023.
- "Areas of pain" (oil and food) are products that Canada exports so we are benefitting from the higher prices caused by the war.
- In this uncertain period, seek the safety of U.S. dollars.
- There has been more clarity in the last few weeks with U.S. inflation falling.
- It has become easier to price risk with corporate earnings still slowing.
- There was a reliance on foreign labour that was closed during the pandemic. This will normalize with time.
- We worry that higher interest rates will lead to a deeper recession.
- We also believe the resiliency of the economy and households is being underestimated. There could be a "soft landing". With the employment report in early January, it is hard to see negative GDP.

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### **CONCLUSIONS FROM KURT & TEAM**

The breakfast discussion was over in less than 90 minutes. Our own team's opinions draw similar conclusions: inflation is beaten, interest rates are peaking, a slowdown more than a recession, a declining real estate market and a rising stock market in 2023.

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