Economic Commentary

First Quarter 2023

Inflation Levels Moderate But Remain Elevated

Headline inflation has moderated over the past several months following the peak levels that were reached last summer. Global central banks have been aggressively raising interest rates in order to combat the extremely high levels of inflation that have existed for almost two years. Core inflation, however, has not declined to the same extent and remains at elevated levels. Headline inflation in Canada now sits at 5.2%, with core inflation at 4.9%. Inflation in the U.S. and Europe remains at higher levels, with headline readings of 6.0% and 6.9%, respectively. Despite the encouraging downward trend, these levels are still a concern for central bankers as inflation remains considerably higher than their 2% target. As a result, most central banks will need to continue to raise administered rates over the near-term.

Banking Issues Roil Markets

Financial markets took a hit in mid-March following the news of the failure of some U.S. regional banks, led by the Silicone Valley Bank. Fears of a contagion in the banking sector, reminiscent of the 2008 Financial Crisis, spooked investors and raised further concerns regarding the stability of the banking system. This was quickly followed by the collapse of Credit Suisse, which escalated banking fears in Europe. Before the banking concerns developed, the debate in financial markets had been about the battle against high inflation vs. the prospect of a recession, given the significant move higher in interest rates by global central banks. The emphasis quickly shifted to combating the current levels of inflation vs. the stability of the overall financial system. Stability and confidence in the financial system is paramount and global central banks moved in quickly to provide the necessary liquidity to help stabilize markets.

Central Banks Open to Less Restrictive Policy

Despite the elevated concerns regarding the stability of the banking sector, global central banks maintained an aggressive stance in the face of the turmoil. There was some thought that central banks would pause at their meetings in March, which took place following the events that occurred in the banking sector. However, the European Central Bank led the way with a 50 bp increase in March, their second move of that magnitude this year. Both the Bank of England and the U.S. Federal Reserve raised rates by 25 bp in March. The Bank of England has raised rates by 75 bp this year, while the Federal Reserve has raised rates by 50 bp. All three major central banks indicated that future rate hikes would be warranted. The Bank of Canada remained on the sidelines, in line with its previous statements. Financial markets have begun discounting interest rate cuts by central banks later this year. This may be premature given the high levels of inflation that still exist.

Given the significant increase in interest rates that has occurred over the past year, along with the recent disruption in the banking sector, fears of a recession have escalated. This has contributed to the belief that administered rates will begin to decline later this year. The price of oil has also declined significantly over the past few months based on fears of a recession. The price of oil did move higher after quarter-end, however, as OPEC announced a surprise cut in production. Despite

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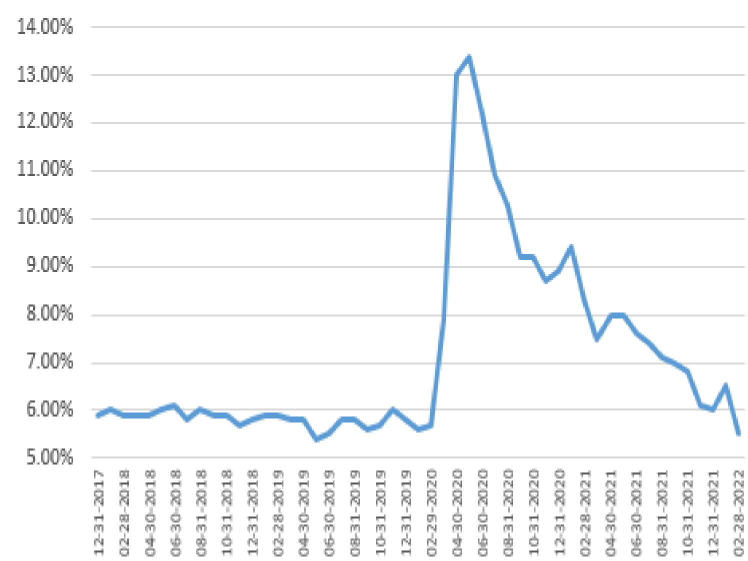
Key Metrics

Indicator	Value	Chg Q1	Chg 1Y
S&P/TSX Composite	20,099.89	4.6%	-5.1%
S&P 500 (USD)	4,109.31	7.5%	-7.8%
iShares MSCI EAFE ETF (USD)	71.52	9.0%	-0.2%
USD/CAD	$ 0.74	0.3%	-7.5%
WTI Crude ($/bl))	$ 75.67	-5.7%	-24.5%
GoC 10Y Bond	2.90%	-40 bps	49 bps
GoC Deposit Rate	4.50%	25 bps	400 bps
Cdn CPI YoY	5.2%	-1.1%	-1.5%
US 10Y Treasury	3.47%	-41 bps	113 bps
Fed Funds Rate	5.00%	50 bps	450 bps
USD CPI YoY	6.0%	-0.5%	-2.5%

Top Themes

- Inflations downward trend is encouraging, but remains too high
- Collapse of SVB and Credit Suisse spook fears of contagion
- Markets price in future rate cuts as Central Banks continue to hike rates

Top Chart: Canada Labour Force Unemployment Rate



Source: Bloomberg, Lincluden

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the fact that forecasts for global economic growth have been ratcheted down of late, several sectors of the economy remain strong. In both the U.S. and Canada, labour markets remain resilient with solid job growth continuing on a monthly basis. Unemployment levels remain at pre-pandemic lows.

Equity Markets Move Higher While Bond Yields Decline

Financial markets continue to be volatile given the adverse developments in the banking sector as well as increased concerns of a recession. Equity markets moved higher earlier in the quarter as there was heightened expectations that central banks would begin lowering interest rates later in the year. Markets took a downturn following the turmoil in the banking sector and the potential impact that it could have on global economic conditions. Markets ended the quarter on the upswing and ended in positive territory. Bond yields moved lower at the beginning of the year before moving dramatically higher as Federal Reserve officials made it clear that aggressive interest rate hikes would be required in order to combat persistent inflation. However, following the banking crisis that occurred in mid-March there was a dramatic flight to quality in government bonds which continued into the end of the quarter. After being poised for additional rate hikes going forward, the market is now anticipating only one more 25 bp move by the Fed in May. Despite the fact that Fed Chair Powell has stated that interest rate cuts are not part of the plan, the market is fighting the Fed and is factoring in lower interest rates by the end of the year.