Economic Commentary

Second Quarter 2023

Inflation Declines, But Remains Elevated

Headline inflation continues to decline but remains at elevated levels. Despite the recent improvement, inflation continues to be a concern for global central banks as levels remain much higher than their 2% target. Even though higher interest rates could have a negative impact on global economic growth, with the possibility of a recession occurring, fighting inflation remains the key goal for central banks. After declining steadily since the peak of 8.1% last June, Canadian inflation unexpectedly moved higher in April, before moving lower again in May. This minor uptick led to a surprise increase in interest rates by the Bank of Canada at the next meeting. Canadian inflation now stands at 3.4%. Although headline inflation has improved considerably, core inflation remains sticky and has not shown the same level of improvement as the broader measure. Inflation in Europe has not improved nearly as much as in North America, with U.K. inflation currently sitting at 8.7%.

Global Central Banks Increase Rates

Global central banks remain resolute in their fight against inflation and continue to raise interest rates. After pausing for several months, the Bank of Canada surprised markets with a 25 bp increase in rates at its June meeting. An unexpected uptick in inflation along with stronger economic demand contributed to the move. In the U.S., the Federal Reserve raised interest rates by 25 bp in May and then paused at its June meeting. This was the first pause by the Fed in 11 meetings, however, they strongly indicated that future moves are expected later this year, with another 50 bp built into their economic projections. Rate hikes in Europe were more aggressive, with the European Central Bank raising rates by 25 bp on two occasions. The Bank of England was even more aggressive with a 25 bp increase in May followed by a 50 bp move in June. Persistent inflation contributed to the larger moves in Europe. Further increases by all of the major central banks are expected to continue throughout the balance of the year. Contrary to previous expectations, interest rate cuts are unlikely to occur until sometime next year.

North American Labour Markets Show Strength

Economic conditions have softened modestly in North America, however, several sectors continue to show surprising strength despite the impact of higher interest rates. Labour markets in both Canada and the U.S. have remained resilient and have provided on-going support to the economy. This is one particular area of the market where both the Bank of Canada and the U.S. Federal Reserve would like to see some weakness develop. Until unemployment levels increase from their pre-pandemic low levels, continued increases in administered rates by central banks are likely to continue. The consumer sector has also been relatively strong with retail sales bouncing back of late. Despite higher mortgage rates that have resulted from the significant increase in interest rates over the past year, the housing sector appears to have rebounded nicely off the lows, particularly in the U.S. There are more short-term and variable rate mortgages in Canada than in the U.S., and one development that has occurred has been an extension of the amortization periods in order to keep monthly

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Key Metrics

Indicator	Value	Chg Q2	Chg 1Y
S&P/TSX Composite	20,155.29	1.1%	10.6%
S&P 500 (USD)	4,450.38	8.7%	19.6%
iShares MSCI EAFE ETF (USD)	72.50	3.2%	18.6%
USD/CAD	$ 0.76	2.1%	-2.8%
WTI Crude ($/bl))	$ 70.64	-6.6%	-33.2%
GoC 10Y Bond	3.27%	37 bps	5 bps
GoC Deposit Rate	4.75%	25 bps	325 bps
Cdn CPI YoY	3.4%	-0.9%	-4.7%
US 10Y Treasury	3.84%	37 bps	82 bps
Fed Funds Rate	5.25%	25 bps	350 bps
USD CPI YoY	4.0%	-1.0%	-5.1%

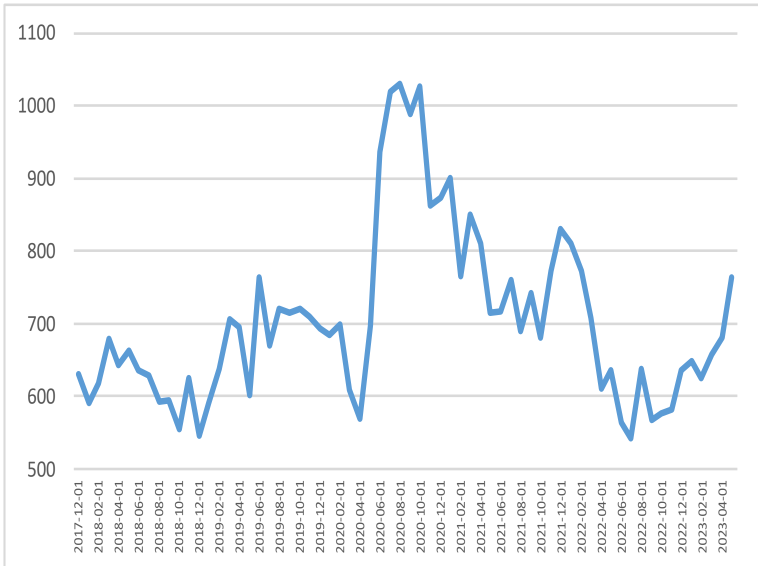
Top Themes

Inflation falling, but remains at stubbornly high levels

Central Banks raise interest rates, expected to remain higher for longer

Housing market stabilizes, shows signs of improvement

Top Chart: U.S. New Home Sales (000's)



Source: Bloomberg, Lincluden

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mortgage payments from moving considerably higher. As a result, a larger portion of an individual's mortgage payment is now going towards the payment of interest and not against the outstanding principal. Also, as shorter-term mortgages come up for renewal, there will be a further burden on the ability to service debt as mortgages will be rolling over at much higher interest rates.

Equity Markets Volatile While Bond Yields Move Higher

Financial markets continue to be volatile given the on-going focus of major central banks in their fight against inflation. These concerns are being weighed against the adverse impact that the cumulative effect of interest rate hikes that have already occurred over the past year could have on the economy. The Canadian equity market was basically unchanged during the quarter, while U.S. equity markets propelled higher based on the strength of a few of the larger technology names. Bond yields moved higher during the quarter by varying degrees as global central banks continue to aggressively address inflationary concerns with higher administered rates. Rate hikes are expected to continue throughout the balance of the year. The benchmark 10 year U.S. Treasury yield increased by 37 bp, to end the quarter at 3.84%. Bond yields at the front end of the yield curve moved higher, both in Canada and the U.S., based on more aggressive expectations of future interest rate hikes by the central banks. .