Economic Commentary

Third Quarter 2022

Persistent Inflation Dominates Markets

Persistent inflation remains the key driver impacting global financial markets. North American inflation levels showed signs of receding during the summer months, however, levels remain elevated and a concern for policymakers. U.S. inflation was 8.3% in August, down from the peak of 9.1% in June. Markets were expecting a lower level and, despite the improving trend, the absolute level was not well-received by the market. In Canada, inflation was 7.0% in August, down from the peak of 8.1%. Expectations were for a higher print, so expectations going forward have improved for Canada. Inflation in the Eurozone continues to escalate, with the September print coming in at a record 10.0%, the highest level since the euro was established over twenty years ago. Central banks have a 2.0% target for inflation, so there is still a long way to go before price stability is achieved.

Central Banks Resolute in Inflation Fight

As inflation levels remain elevated, both the U.S. Federal Reserve and the Bank of Canada have become more aggressive in their interest rate policy. The potential terminal rate keeps getting pushed higher, along with the expectation that the end rate will remain in place for an extended period of time. The Fed raised rates by 75 b.p. at each of its two meetings during the quarter while the Bank of Canada raised rates by 100 bp in June and 75 bp in September. On a year-to-date basis both central banks have raised interest rates by 300 bp. The number one goal of the Fed and the Bank of Canada is to reign in inflation. They are prepared to continue to aggressively raise interest rates 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 during the quarter. With Eurozone inflation running at a record 10.0%, the ECB will need to continue to be aggressive on the rate front. Other global central banks have also joined the mix and tightened monetary policy during the quarter

Economic Outlook Deteriorates

As central banks become increasingly more aggressive in raising interest rates, one fallout that will occur is a slowdown in economic activity. The goal of the central banks is to negotiate a soft landing, however, as interest rate expectations continue to escalate, the likelihood that this will occur is reduced. The potential for a recession has increased, with global financial markets now viewing this as a more probable outcome. Second quarter GDP in the U.S. was (0.6%), following a decline of 1.6% in the first quarter. Data in Canada are reflecting slower economic growth as well. Monthly GDP gains for both June and July were only 0.1%. The housing sector continues to be negatively impacted by the significant interest rate hikes that have occurred this year, both in Canada and the U.S. Labour markets will be watched for any signs of weakness. U.S. employment remains resilient while the Canadian labour market has shown signs of weakness over the past several months.

Canadian Dollar Hit Hard

The Canadian dollar declined significantly during the quarter as the U.S. dollar strengthened on anticipation of a more aggressive interest rate policy by the U.S. Federal Reserve. Inflation in the U.S. is more elevated than in Canada and continues to surprise on the upside. This has led to the belief that the Fed will need to raise interest rates to a larger extent than the Bank of Canada. In addition, the increasing possibility of a recession occurring has led to a risk-off

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Key Metrics

Indicator	Value	Chg Q1	Chg 1Y
S&P/TSX Composite	18,444.22	-1.4%	-5.3%
S&P 500 (USD)	3,585.62	-4.9%	-15.5%
iShares MSCI EAFE ETF (USD)	56.01	-10.4%	-25.1%
USD/CAD	$ 0.72	-6.9%	-8.3%
WTI Crude ($/bl))	$ 79.49	-24.8%	5.9%
GoC 10Y Bond	3.17%	-5 bps	+166 bps
GoC Deposit Rate	3.25%	+175 bps	+300 bps
Cdn CPI YoY	7.0%	-1.1%	2.6%
US 10Y Treasury	3.83%	+82 bps	+234 bsp
Fed Funds Rate	3.25%	+150 bps	+300 bps
USD CPI YoY	8.3%	-0.8%	2.9%

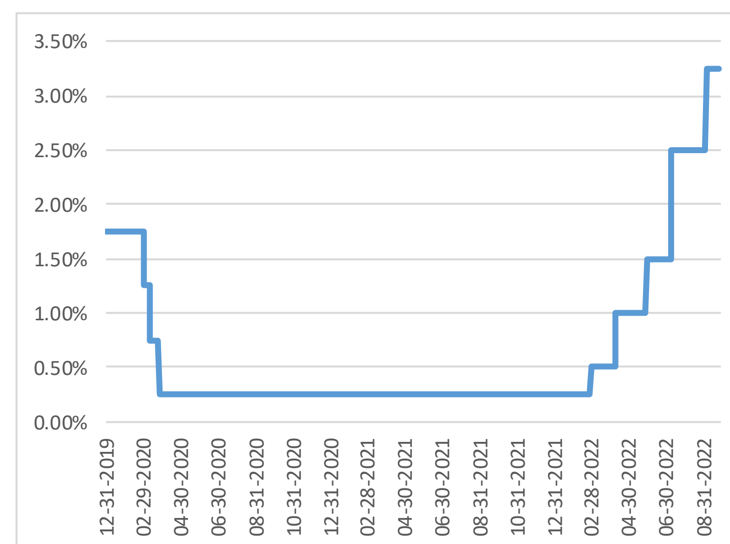
Top Themes

Both Central Banks and markets keenly focused on inflation

Recessionary fears becoming more pronounced

Volatility returns to both bond and equity markets

Top Chart: Bank of Canada Overnight Lending Rate (%)



Source: Bloomberg, Lincluden

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environment, adding further fuel to an already strong U.S. dollar. The price of oil has also declined dramatically during the summer. Although the Canadian dollar did not gain as much as one would have expected when oil prices were rising, it now appears to be declining in part due to lower oil prices.

Equity Markets Volatile, Bond Yields Diverge

Equity markets were extremely volatile during the quarter, however, they ended relatively unchanged. More aggressive interest rate hikes by North American central banks, along with an increased probability of a recession, wiped out the strong gains that were achieved during the first part of the quarter. Equity markets have experienced significant declines on a year-to-date basis, with the Canadian TSX lower by 13%. The U.S. S&P and NASDAQ indices are both in bear market territory, with losses of 25% and 32%, respectively. Bond yields in the U.S. continued to move higher on the back of aggressive interest rate hikes by the Fed. The yield on the benchmark 10 year U.S. Treasury bond ended the quarter at 3.83%, up 81 b.p. during the period. The yield briefly pushed through 4% late in the quarter. Canadian bond yields decoupled from U.S. yields during the quarter, based on the expectation that the Bank of Canada may not need to increase rates in lockstep with the Fed. The yield on the 10 year Government of Canada bond ended the quarter at 3.17%, down 5 bp. The yield curve continues to flatten and is now inverted throughout the various maturities along the curve as the magnitude of projected interest rate increases continues to surprise on the upside.