Economic Commentary

Fourth Quarter 2023

Inflation Resumes Downward Trend

After peaking in June 2022, North American inflation has declined dramatically. Although there was a modest back-up during the summer months of this year, the downward trend has been re-established. Both Canadian and U.S. annual inflation now sit at 3.1%, after peaking at 8.1% and 9.1%, respectively, last year. Although the core inflation readings have declined as well, the data continues to remain higher than the headline rate. Core inflation is 3.5% in Canada and 4.0% in the U.S. This consistent downward trend has allowed central banks to refrain from increasing interest rates any further. Inflation declines in Europe have been even more impressive than in North America. U.K. inflation has declined from a peak of 11.1% to a current rate of 3.9%, while inflation in the Eurozone has declined from 10.6% to 2.4%. Despite these declines, however, inflation continues to be the main driver of financial markets as we begin 2024 as levels remain higher than the 2% target of most major central banks.

Global Central Banks Pivot

Major global central banks remained on hold during the fourth quarter, following earlier increases during the year. Despite the fourth quarter pause in rate hikes, the Bank of Canada raised interest rates by 75 bp during the year while the U.S. Federal Reserve increased its overnight rate by 100 bp. Central banks have now pivoted from an environment of consistent interest rate increases to one where they are now contemplating the prospect of lowering rates. Both the BOC and the Fed had called for interest rates to remain higher for longer, however, at its most recent meeting, Fed governors began forecasting lower rates in 2024, with projections indicating interest rates could decline by 75 bp next year. Financial markets, on the other hand, have begun discounting more aggressive declines in interest rates than what the central banks are implying. Current expectations are calling for interest rates to decline by over 150 bp, both in Canada and the U.S. There is an obvious disconnect between central banks and the markets in terms of the expected path of interest rates in 2024 as financial markets may be overestimating the extent of potential interest rate declines. Future moves will continue to be data dependent, with inflation, the state of the labour market as well as underlying economic conditions dictating the future path of interest rates.

Prospects For Soft Landing Improve

Economic conditions have not declined to the extent that one would expect, given the significant interest rate hikes by global central banks over the past two years. Although economic growth has slowed in many regions around the world, the downturn has not been as severe as originally forecast. GDP readings in Canada have been flat for the past three months, following a couple of negative monthly readings during the summer. The recent decline in five year bond yields, along with the prospect of interest rate cuts by the Bank of Canada, should provide some relief to the Canadian housing market in 2024, given the reliance on shorter-term mortgage financing in Canada. There continues to be solid monthly job gains in Canada, however, the

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Key Metrics

Indicator	Value	Chg Q4	Chg 1Y
S&P/TSX Composite	20,958.44	8.1%	11.8%
S&P 500 (USD)	4,769.83	11.7%	26.3%
iShares MSCI EAFE ETF (USD)	75.35	10.7%	18.4%
USD/CAD	$ 0.76	2.5%	2.3%
WTI Crude ($/bl))	$ 71.65	-21.1%	-10.7%
GoC 10Y Bond	3.11%	-92 bps	-19 bps
GoC Deposit Rate	5.00%	0 bps	75 bps
Cdn CPI YoY	3.1%	-0.7%	-3.2%
US 10Y Treasury	3.88%	-69 bps	0 bps
Fed Funds Rate	5.50%	0 bps	100 bps
USD CPI YoY	3.1%	-0.6%	-3.4%

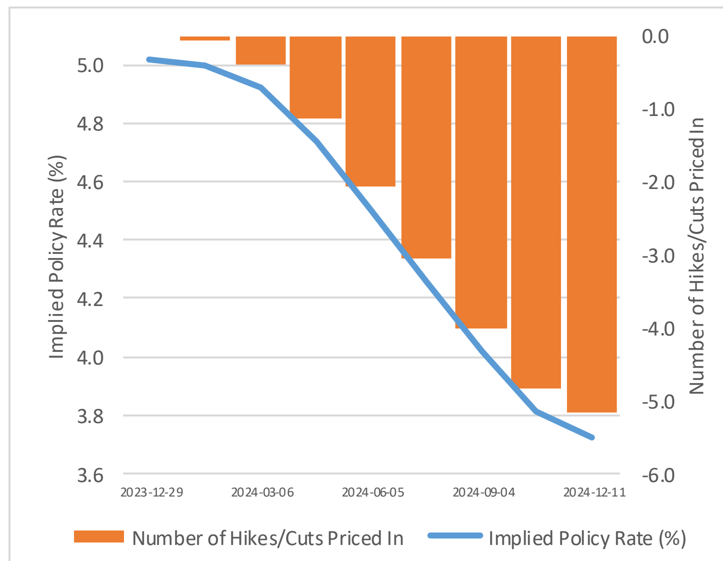
Top Themes

Following modest backup, inflation resumes downward trend

Central Banks pivot from rate hikes to rate cuts

Possibility of a soft landing scenario becoming more plausible

Top Chart: U.S. Implied Overnight Rate & Number of Hikes/Cuts



Source: Bloomberg, Lincluden

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unemployment rate has moved higher, given the large influx of available workers into the country during the past year. The U.S. economy has fared much better than the rest of the world, with GDP increasing by an annual rate of 4.9% in the third quarter. A robust consumer sector, along with a resilient labour market, have helped drive economic performance. Although the unemployment rate has inched higher this year, it is still well below levels that the Federal Reserve would like to see in order to slow economic growth.

Equity Markets Move Higher, Bonds Yields Rally

The Canadian equity market rallied during the final two months of the year to finish off on a positive note. After hitting the lows of the year in October, the S&P/TSX Index bounced back strongly to end the year with a return of 8.1%. U.S. equity indices performed much better, with the S&P 500 and NASDAQ returning 24.2% and 43.4%, respectively. Prospects for interest rate cuts, along with the increased likelihood of a soft economic landing, helped propel the equity markets higher. Bond yields moved substantially lower during the quarter as central banks pivoted on their outlook for interest rates, with rate cuts being forecast later in 2024. The benchmark 10 year U.S. Treasury yield declined by 69 bp, finishing the year at 3.88%, the same level where it started the year. Despite the unchanged level on the year, there was extreme volatility, with the 10 year bond hitting a low of 3.31% and a high of 5.00%.