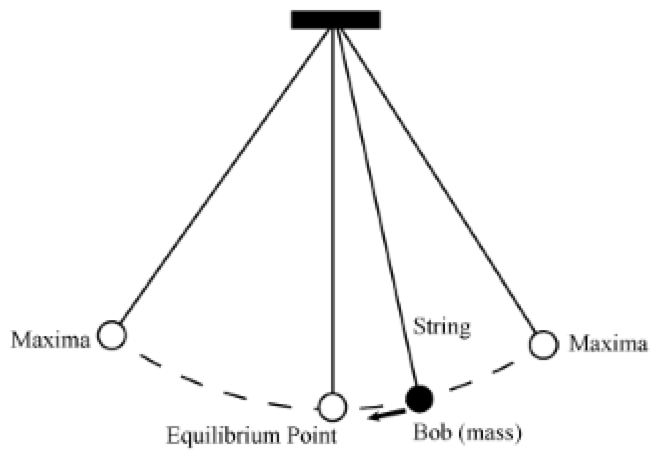
From: Ermes Monaco <e.monaco@iaprivatewealth.ca>
Sent: October 14, 2022 4:21 PM
To: Ermes Monaco <e.monaco@iaprivatewealth.ca>
Subject: VALUED CLIENT MAIL LIST: Economic Outlook - MID FALL 2022
Importance: High



Lower Inflation and Lower Rates **Higher Inflation and Higher Rates**

Author's Interpretation from Google Image

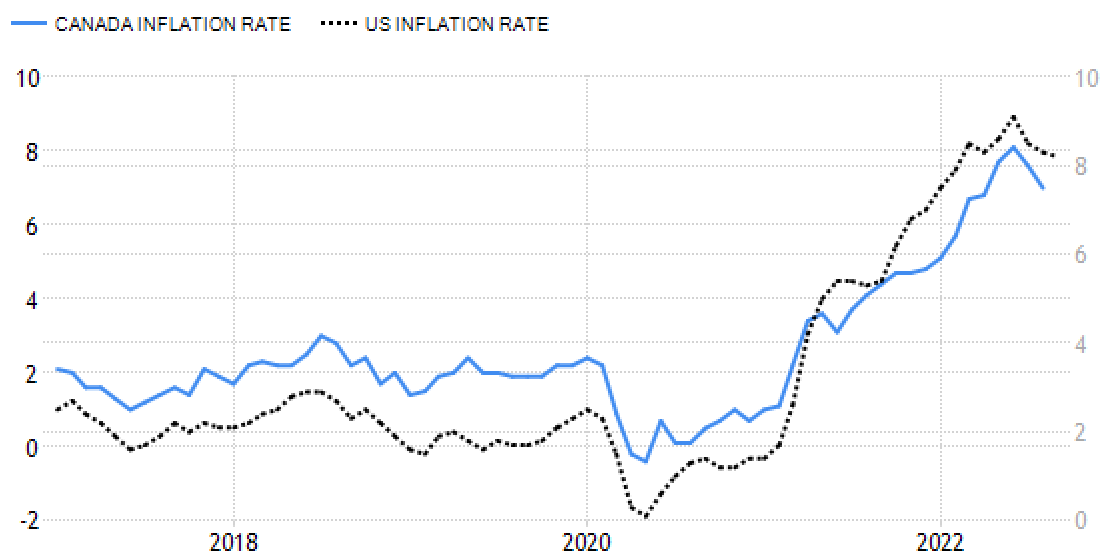
FINDING EQUILIBRIUM

Author's Note: Because of the duration and impact of the current inflation cycle, I am taking the liberty to publish these newsletters more frequently to help provide some insight during this time.

IT IS APPARENT BY NOW that inflation is resisting despite the interest rate increases that have been levied by the central banks this year. The underlying bank rate set by the Bank of Canada has risen 300 basis points from .25% in January to 3.25% currently. There are two further bank rate setting meetings this year both in Canada and the U.S. which will inevitably result in further increases.

THIS has begun to show signs of weakness in consumer demand and prices for real estate and gas at the pump in particular. However, other commodities such as food continue to be inflated and "inelastic" as is described in economic terms. We can delay buying a new home or driving more frequently but food is an unavoidable commodity. Part of this inelasticity may also be a situation of "price exploitation" by the food providers not passing on savings despite some operating costs having declined since the initial Covid event *(Canadian Press Oct 17)*.

OTHER economic forces are also acting to aggravate inflation and prevent it from declining faster. <u>It is important to recognize while there has been a change in the *trend* of inflation the pace has been too slow for the central banks to declare that it has peaked in order to start easing rates.</u>



Source: Tradingeconomics.com

WHAT ARE THE FACTORS CONTINUING TO DRIVE INFLATION?

We have been speaking of these in the newsletters during this inflation cycle. Some of the major contributors remain:

1. **CONTINUED POSITIVE CONSUMER SENTIMENT AND DEMAND following the Covid lock down driving the need to "catch up". Higher prices have not deterred spending appetite sufficiently.**
2. **HIGH EMPLOYMENT AND LOW UNEMPLOYMENT as companies ramp up to meet increased demand for goods and services; the shortage of staff is resulting in higher wages.**
3. **SAVINGS from reduced spending during the Covid cycle together with government Covid assistance created a consumer cash surplus. While this is declining, there is still sufficient available to continue to fuel spending.**
4. **INTEREST RATES themselves are contributing to inflation.**

FINDING EQUILIBRIUM

RECESSION has already technically occurred due to the interest rate environment having caused GDP to decline for two quarters. Yet, as we've noted, GDP remains positive despite the decline. The International Monetary Fund (IMF) has projected Canada will continue to have a positive GDP of 1.5% in 2023 despite declining from 3.3% in 2022 (IMF.org).

THEREFORE, as we progress into 2023 we will likely see the next cycle characterized by a <u>new equilibrium</u> where:

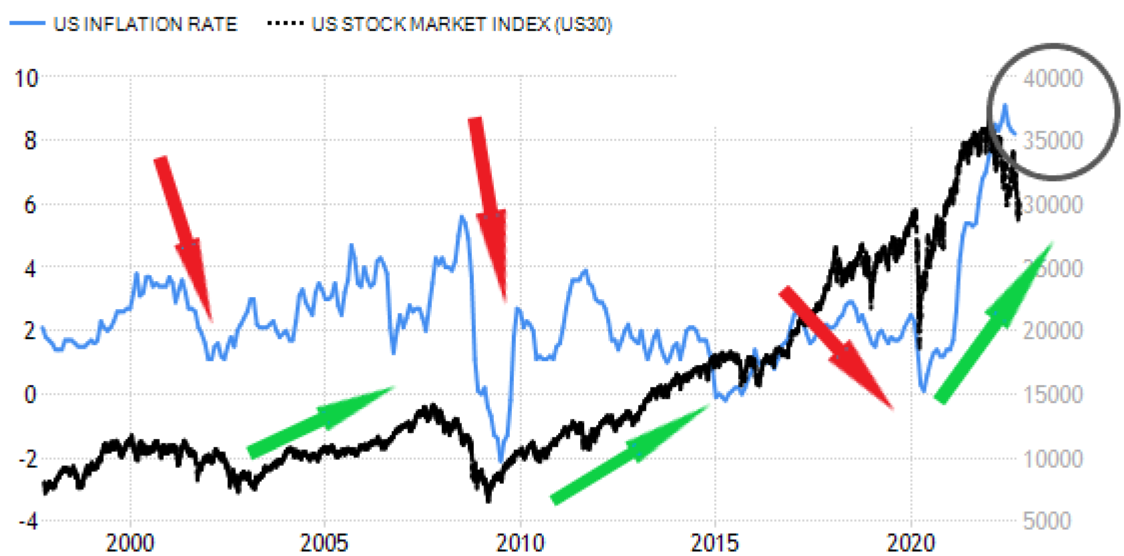
- **Interest rates will remain above the lows of 2021 but eventually decline below current levels as inflation gradually wanes and approaches the target range.**
- **GDP will be lower but remain positive**
- **Consumer demand will moderately decline.**

- **Unemployment will increase as companies reduce staff to adjust to the new level of spending although employment will remain healthy.**
- **Wage pressure will level off.**
- **Prices for good and services will stabilize allowing harder hit sectors such as real estate to resume positive activity.**

IMPORTANTLY,

WE SHOULD EXPECT THE FINANCIAL MARKETS TO RECOVER AS MARKET PRICES ONCE AGAIN REFLECT UNDERLYING CORPORATE EARNINGS AND VALUE WITHOUT INFLATION DESTRUCTION.

MOVEMENT IN INFLATION (RED ARROWS) FOLLOWED BY MARKET RECOVERY (GREEN ARROWS)



Regards

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