From: Ermes Monaco <e.monaco@iaprivatewealth.ca>
Sent: February 13, 2023 10:48 AM
To: Ermes Monaco <e.monaco@iaprivatewealth.ca>
Subject: VALUED CLIENT MAIL LIST: Economic Outlook - Start of 2023

WAITING FOR INFLATION TO BREAK UP

Source: Google Image

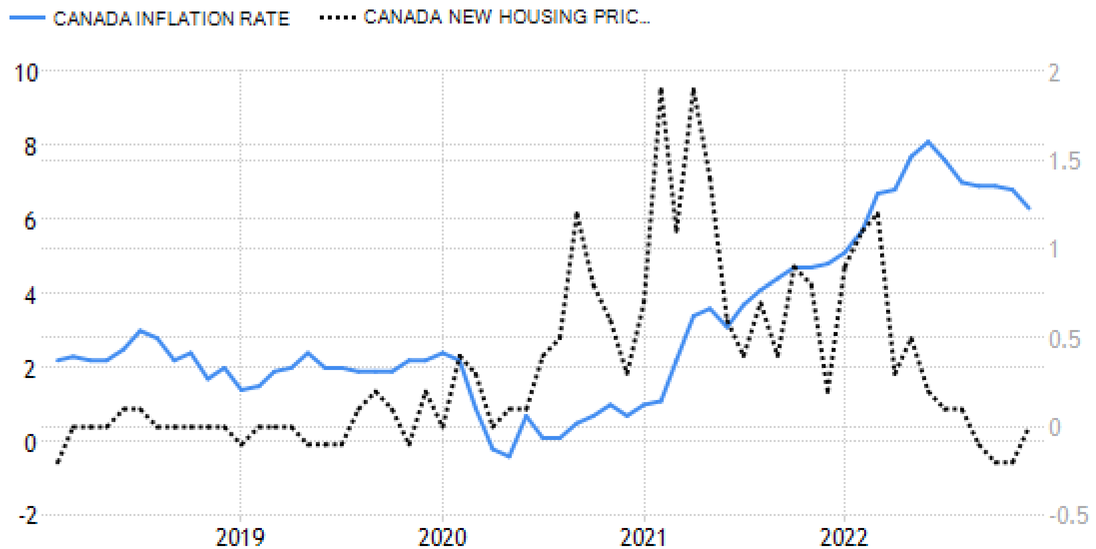
WE'RE APPROACHING almost one year since the North American central banks began their interest rate increases to combat post-Covid fueled inflation.

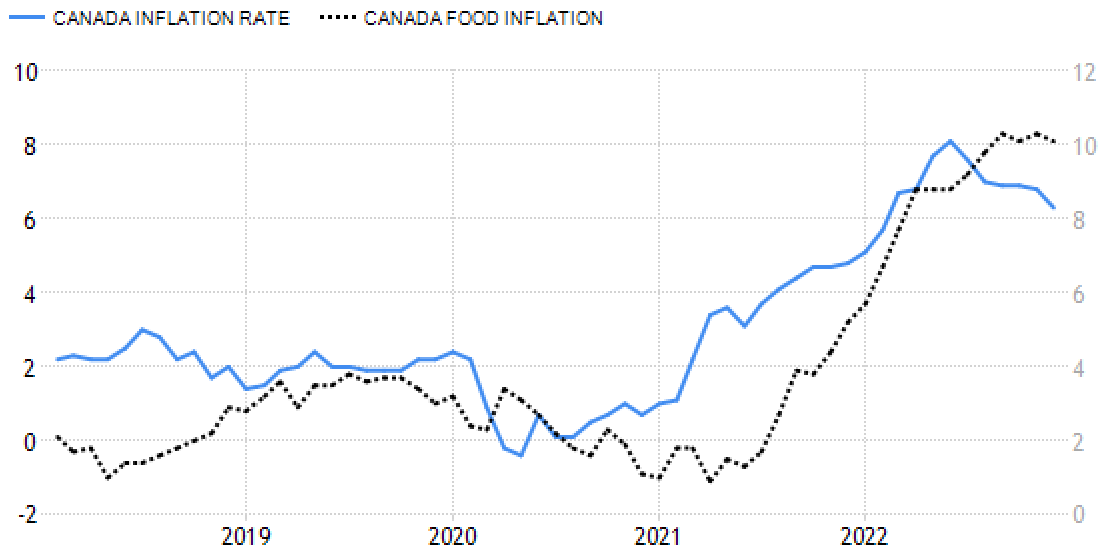
IT MAY BE PROVING to be using a sledgehammer to drive in a nail, or, perhaps many nails.

AT FIRST the main targets were big ticket items such as housing and autos for which prices had risen dramatically due to low interest rate driven demand. Consumers were weary of the limitations of goods due to the impact of Covid and were eager to borrow and spend again. The interest rate campaign has had a material impact on the cost and value of real estate which remains down -16.9% from an index high in 2022 ***(Thomson Reuters).*** **<u>The action was immediate and effective as mortgage rates have directly increased with each rate hike.</u>**

HOWEVER the persistence of inflation embedded in other less costly but more frequent consumer items such as food and gasoline is causing inflation to remain sticky and slow to decline. The underlying drivers differ from those which have affected housing costs. Yet, over time the cumulative cost of living has been significant.

The Relative Decline in the Price of New Housing and Food vs Inflation





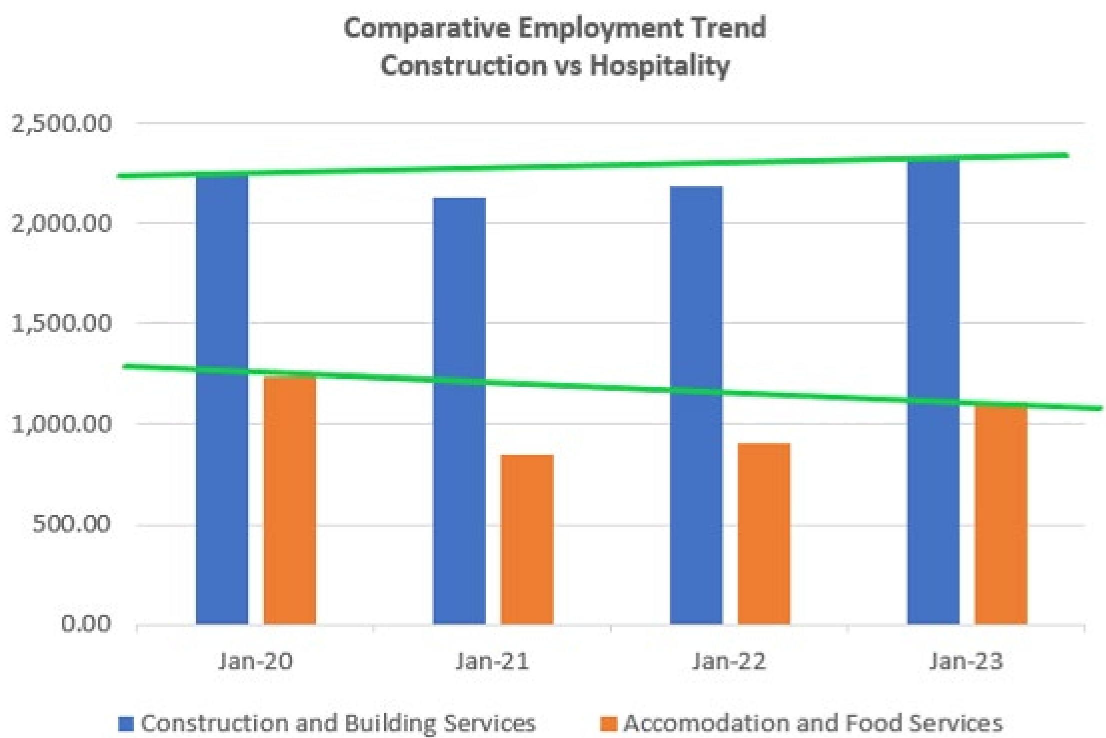
Sources: Trading Economics

THE ATTENTION is now focused on another economic target that can be influenced to weaken the grip of inflation. Employment and Unemployment are seen as drivers that can weaken inflation across multiple inflation fronts. If total number of employed declines and unemployment rises sufficiently the consumer's disposable income should also decline and lead to lower spending and a reduction in inflation.

YET IT'S A NO PAIN NO GAIN situation to undermine employment and unemployment in the interest of economic benefit as livelihoods will be threatened and quality of life

compromised. While many thousands of jobs have been lost in the tech sector other industries continue to be short staffed and are working to attract workers back having never fully re-staffed post covid.

- **The hospitality and retail sectors suffered the greatest job losses during covid and have demonstrated healthy job recovery although they continue to have difficulty attracting workers back.**
- **The lack of available trades is being cited as a factor in the cost and availability of construction and housing. Despite the impact of mortgage rates on demand, a material decline in the building sector due to labour shortage would impact Canada's GDP given the importance this area has to the country's economy.**



Source: Statistics Canada (000's)

THIS EMPLOYMENT SHIFT suggests consumer spending and inflation may not be tamed this year. The former Bank of Canada Governor Mark Carney suggested in an interview on BNN Feb 9 that the central banks may not ease interest rates at all this year due to persistent inflation.

BUT FREE MARKETS also work in seemingly mysterious ways as money and capital like water always finds its way. The threat and effect of sustained or even higher interest rates may also lead to "inflation fatigue" and act to slow consumption and productivity to the point of recession which, in turn, will lead to declining inflation.

THEREFORE IT IS A MATTER OF NOT IF BUT WHEN we'll see the current state of stagflation break up as inflation declines and recovery resumes throughout the economy. While it may not seem soon enough it is quite likely we will see a sufficiently different picture in the second half of this year. It will be best to manage expectations as inflation may not decline to pre-Covid levels in 2023. Nonetheless, incremental improvement which signals a new gradual recovery trend remains the current consensus.

IN THE MEANTIME . . .

We recommend continued diligence with respect to market risk in our portfolios while gradually lessening defensive strategies to benefit from emerging opportunities as the financial markets look forward to recovery.

Regards

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