2023 Economic Outlook Breakfast Meeting

Friday, January 13, 2023

An annual January event where some of Canada's leading chief economists share their economic predictions for 2023, at a breakfast in Toronto hosted by the Economic Club of Canada.

Present this year:
Beata Caranci, Chief Economist, TD Bank
Craig Wright, Chief Economist, RBC
Douglas Porter, Chief Economist, BMO Financial Group
Jean-Francois Perrault, Chief Economist, Scotiabank

The following notes are a summary of the conversation in the order that it occurred and paraphrased by Kurt Rosentreter, President, Upper Canada Capital and Senior Financial Advisor for Manulife Securities.

ON THE CANADIAN ECONOMY RIGHT NOW…

Douglas:

- The Canadian economy had more momentum at the end of 2022 than we expected.
- A lot of "pandemic savings" means Canadians are sitting with money and there is also pent-up demand to spend.
- The Canadian economy remains strong despite higher interest rates (seven interest rate increases in Canada in 2022).
- We believe that the Canadian inflation rate will settle in at 5%.

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- We can see interest rates going higher in 2023 if the economic strength in Canada continues too much.

Jean-Francois:

- We believe the Bank of Canada could engineer a soft landing for the economy in Canada despite much higher interest rates and a cooling economy.
- We have a 3.6% inflation estimate for Canada.
- Canadian economy is proving to be robust and resilient.

Beata:

- A recession in Canada would have fewer job losses as many companies already have lean employee levels and hiring. Perhaps 100,000 job losses which is 1/3rd of normal in a recession.
- We are already at the trough of where we would see unemployment levels at.
- We see oil at $90 a barrel with China re-opening.

Craig:

- We predicted a recession in Canada last July as tailwinds (free trade, cheap credit, low-cost labour) turns to headwinds: Free trade is now re-shoring; free money now costs 4%; carbon tax costs and labour cost is up.
- The pain is yet to come in our economy as the lag on rising interest rates eventually hits the economy. The housing market is rolling over.
- We see Canadian inflation at 1% to 3% by the end of 2023 with core inflation at 3%.
- There is a risk that the Bank of Canada goes too far in raising interest rates.

Douglas:

- US will have 6.5% headline inflation; 6.5% to 7% inflation for 2023.

- Hard to see them get to 2% inflation.

Jean-Francois:
- Getting close to a Bank of Canada pause on rising interest rates; might do 0.25% in January {and they did, Kurt}.
- Bank of Canada is aware of the magnitude of their decisions and may take 18-24 months to assess what to do next.

Beata:
- We see a 0.25% Bank of Canada interest rates increase in January {which is what happened, Kurt}.
- The central banks are fighting for credibility after being wrong on inflation in 2021.

Craig:
- Bank of Canada was late to start raising interest rates.
- Government over-spending during the pandemic has increased the inflation problem.

ON HOUSING IN CANADA…

Douglas:
- There is a housing bubble in south-western Ontario.
- We expect prices to drop -25%.
- We are not concerned about mortgage defaults.
- There is a record 300,000 homes under development in Canada.

Beata:

- There is strong population growth expected of 500,000 people a year concentrated in mostly five cities in Canada.
- Can only build so fast.

Jean-Francois:

- We see housing affordability getting worse in the years ahead.
- This won't change until housing supply is fixed.
- Canadians are facing a $400 to $700/month mortgage payment increase with higher interest rates.
- People are managing so far – mortgage defaults are not up yet.
- Housing market is critical to employment numbers.

Craig:

- There are 10 million millennials to buy homes; they will be ok as long as they have jobs.

ON THE UNITED STATES…

Beata:

- U.S. is more resilient than Canada due to less leverage. They have lower debt servicing costs.
- We expect the U.S. to outperform Canada this year. They have leaner industrial operations. Culturally, the U.S. is fast to fire people.
- We forecast 1.5M job losses in the United States.

Douglas:

- For Ontario and Canada, we expect a fiscal surplus.
- For the U.S. we expect a $1.4 trillion dollar deficit or 5% of GDP (gross domestic product).
- There is a coming debt ceiling crisis; expect government spending cuts.

Jean-Francois:

- The U.S. has fewer economic support programs than Canada during the pandemic.

Craig:

- We see Canada outperforming the U.S. in 2023 GDP.
- The U.S. has a lower savings rate; Canada has more growth potential including a lift from Alberta.

ON THE WORLD AND IN GENERAL…

Douglas:

- We are optimistic about China's re-opening but worried about geo-political risk in China, Iran, North Korea and Russia.
- We are not bullish on commodities in a slowing economy.
- U.S. had 7% inflation before the war.
- We see a lower Canadian dollar due to a stronger U.S. dollar. 75 cents is fair value in our estimation.
- U.S. dollar will fall as interest rate hikes stop.
- Euro strengthened against the Canadian dollar during 2022. Canadian dollar is weaker due to lower commodity prices.

- We are uncertain about 2% being the best standard for governments to use for inflation.
- There is a policy induced slowdown going on where governments know what to do. We could see a "Goldilocks" result with higher interest rates but no recession.

Craig:

- International Monetary Fund has global growth at 1.5% and China at 4.4% in 2023; that is a downward trend.
- Ukraine war creates a lot of geo-political uncertainty.
- Sector specific taxation in Canada is bad policy. Uncertain about carbon pricing.
- We need to rebrand Canada as open for global market investment.
- Canada is too focused on short term solutions – we need to up our game on global capital flows and increase our productivity.
- Consumers have a war-chest of savings in place. Spending continues which leads to growth.
- There will be a rough spring housing market.

Beata:

- We have oil at $90/barrel, up from $75/barrel now.
- Surging U.S. exports in liquified natural gas (LNG).
- Europe is evolving.
- Lost the "kumbaya" moment in globalization. Global, integrated supply chains concentration risk to countries.

- Wages will be the largest determinant of inflation. Already seeing U.S. wage pressures ease. 2023 will get close to what employers can bear on the cost of labour.
- Cost of shelter is a lag on inflation in the U.S. which is in the turn on inflation.
- Canada relies on people instead of processes (e.g., international nurses) – our problems are not fixed by immigration. We have fewer doctor residency spots in Canada today than in the 80s.
- We are bracing for a recession.

Jean-Francois:

- The impact of the war in Ukraine depends on where you are:
  - Europe will have a recession in 2023.
  - "Areas of pain" (oil and food) are products that Canada exports so we are benefitting from the higher prices caused by the war.
- In this uncertain period, seek the safety of U.S. dollars.
- There has been more clarity in the last few weeks with U.S. inflation falling.
- It has become easier to price risk with corporate earnings still slowing.
- There was a reliance on foreign labour that was closed during the pandemic. This will normalize with time.
- We worry that higher interest rates will lead to a deeper recession.
- We also believe the resiliency of the economy and households is being under-estimated. There could be a "soft landing". With the employment report in early January, it is hard to see negative GDP.

CONCLUSIONS FROM KURT & TEAM

The breakfast discussion was over in less than 90 minutes. Our own team's opinions draw similar conclusions: inflation is beaten, interest rates are peaking, a slowdown more than a recession, a declining real estate market and a rising stock market in 2023.

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