

WEEKLY COMMENTARY



The Three 'Rs' of 2023: Rates, Recession, Recovery

By Randall Bartlett, Senior Director of Canadian Economics

On this dubious day in recent US history, it feels a little bit like cresting the top of a rollercoaster before taking a sharp drop on the other side. The global economy has yet to feel the full effects of aggressive interest rate hikes through 2022. These will continue to weigh on economic activity and risk assets in 2023, hitting interest-rate-sensitive parts of the economy particularly hard. Indeed, we believe hard enough to drive many major advanced economies into recession. And there are more hikes on the way from several central banks. This ongoing tightening will weigh on global economic activity and risk assets further in 2023. (See our [Economic and Financial Outlook](#) for more information on our forecasts.)

But remember this is by design. The economic and financial market correction we're currently living through is the expressed intent of monetary policy tightening. And the slowing pace of global demand on the back of higher interest rates is starting to be reflected in inflation. Global drivers of goods inflation related to supply chains and shipping costs have come down quickly. Oil prices have also fallen sharply from their 2022 peak, and energy is likely to soon be a drag on headline inflation. Other commodity prices have followed suit. The primary driver of inflation has now become services as wage growth remains persistently high. This is particularly concerning for the Fed, as wage gains in the US have generally outpaced other advanced economies and risk leading to a dreaded wage-price spiral. Unfortunately, when you've got a wage-price fever, the most effective prescription is a recession. Research by our Macro Strategy team has verified that this has been the case in the US going back at least four decades. A recession will cool the red-hot demand for labour and bring down wage growth in the process. However, while the unemployment rate is expected to rise in advanced economies, the short and shallow nature of the recession that we anticipate in our baseline scenario is unlikely to lead to an all-out correction in the labour market. Instead, we're expecting more of a

rebalancing of the job market, with the unemployment rate rising modestly above its pre-COVID average before returning to a more typical level.

As the pace of inflation and wage growth starts to come down, the inflation expectations of consumers and businesses should follow suit. This is the trifecta of price indicators central banks will be leaning on to first pause in hiking rates and then take their feet off the brake. We expect this will all come together in the second half of 2023, prompting all major advanced economy central banks to cut their respective policy rates before the year is out. But markets will anticipate this long in advance. Indeed, longer-term bond yields have already come off their recent highs as central banks inch closer to reaching their as-of-yet-undefined terminal rates. That will help alleviate some pain from interest-rate-sensitive assets even as earnings remain challenged in an environment of weak to negative growth. But as the global economy begins to recover and growth momentum gets reflected in forward earnings, the return on risk assets should rebound along with it. We expect this will lead to a positive return on risk assets by year-end 2023—albeit with more pain before then—and tee up an even more vigorous rebound in 2024. (You can find our latest asset return forecasts [here](#).)

So, buckle up. 2023 is going to be a bumpy ride. But this too shall pass. Be ready for it.

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What to Watch For

By Randall Bartlett, Senior Director of Canadian Economics, Tiago Figueiredo, Associate – Macro Strategy, Marc Desormeaux, Principal Economist, and Francis Généreux, Principal Economist

THURSDAY January 12 - 8:30

December	m/m
Consensus	0.0%
Desjardins	0.0%
November	0.1%

FRIDAY January 13 - 10:00

January	Index
Consensus	60.5
Desjardins	59.5
December	59.7

MONDAY January 9 - 8:30

November	m/m
Consensus	n/a
Desjardins	-0.1%
October	-1.4%

FRIDAY January 13 - 2:00

November	m/m
Consensus	-0.3%
October	0.5%

UNITED STATES

Consumer price index (December) – At 7.1%, inflation was already 2 percentage points below its June 2022 peak in November and likely continued to ease in December. Energy prices are expected to fall substantially, with gasoline pump prices down 12.7% (although the fall will be tempered by seasonal effects). Growth in food prices should come in a little higher than November's 0.5%. Stripping out food and gas, we also expect growth slightly above November's rate of 0.2%. Still, the downward trend in goods prices (particularly used cars and trucks) is expected to continue, although it will be offset by a stronger upward trend in service prices. Overall, the month-over-month change in the all items index should come in at 0.0%. The year-over-year change in the all items index should fall from 7.1% to 6.5%, with core inflation edging down from 6.0% to 5.7%.

University of Michigan consumer sentiment index (January, preliminary) – In December, the University of Michigan consumer sentiment index recovered almost all the ground it had lost in November. After falling from 59.9 in October to 56.8 in November, it climbed back up to 59.7, according to final December figures, supported by falling gas prices and the general easing of inflationary pressure. But circumstances might prove a little more difficult in January. Stock markets have been down somewhat since mid-December, and both gas prices and mortgage rates have started to creep back up again. We therefore expect a slight drop in the University of Michigan consumer sentiment index.

CANADA


Building permits (November 2022) – The value of building permits is expected to have posted a modest contraction in November, likely falling by 0.1% in the month. Existing home sales fell in November while housing starts have been on a downward trend since September. At the same time, the average price of new and existing homes also took a step back in the month. Taken together, these indicators suggest the weakness seen in building permits in September and October is probably going to persist.

OVERSEAS

United Kingdom: monthly GDP (November) – UK monthly GDP took a dive in September before rebounding in October, largely due to impacts from the national mourning period for Queen Elizabeth II. A more normal trend has probably established itself as of November, but it might not be all that rosy. The UK economy has a number of challenges ahead of it and has likely already entered a recession, according to the Bank of England. Don't be surprised to see a drop in monthly real GDP for November.


Economic Indicators

Week of January 9 to 13, 2023

Day	Hour	Indicator	Period	Consensus		Previous data
UNITED STATES						
MONDAY 9	12:30	Speech of Federal Reserve Bank of Atlanta President R. Bostic				
	15:00	Consumer credit (US\$B)	Nov.	25.0	23.0	27.1
TUESDAY 10	9:00	Speech of Federal Reserve Chair J. Powell				
	10:00	Wholesale inventories – final (m/m)	Nov.	1.0%	1.0%	1.0%
WEDNESDAY 11	---	---				
THURSDAY 12	7:30	Speech of Federal Reserve Bank of Philadelphia President P. Harker				
	8:30	Initial unemployment claims	Jan. 2-6	n/a	215,000	204,000
	8:30	Consumer price index				
		Total (m/m)	Dec.	0.0%	0.0%	0.1%
		Excluding food and energy (m/m)	Dec.	0.3%	0.3%	0.2%
		Total (y/y)	Dec.	6.6%	6.5%	7.1%
		Excluding food and energy (y/y)	Dec.	5.7%	5.7%	6.0%
	11:30	Speech of Federal Reserve Bank of St. Louis President J. Bullard				
	14:00	Federal budget (US\$B)	Dec.	n/a	n/a	-248.5
FRIDAY 13	8:30	Export prices (m/m)	Nov.	-0.7%	-0.7%	-0.3%
	8:30	Import prices (m/m)	Nov.	-0.9%	-0.8%	-0.6%
	10:00	Michigan's consumer sentiment index – preliminary	Jan.	60.5	59.5	59.7

CANADA

MONDAY 9	8:30	Building permits (m/m)	Nov.	n/a	-0.1%	-1.4%
TUESDAY 10	5:10	Speech of Bank of Canada Governor T. Macklem				
WEDNESDAY 11	---	---				
THURSDAY 12	---	---				
FRIDAY 13	---	---				

Note: Desjardins, Economic Studies are involved every week in the Bloomberg survey for Canada and the United States. Approximately 15 economists are consulted for the Canadian survey and a hundred or so for the United States. The abbreviations m/m, q/q and y/y correspond to monthly, quarterly and yearly variation respectively. Following the quarter, the abbreviations f, s and t correspond to first estimate, second estimate and third estimate respectively. The times shown are Eastern Standard Time (GMT - 5 hours).  Forecast of Desjardins, Economic Studies of the Desjardins Group.

Economic Indicators

Week of January 9 to 13, 2023

Country	Hour	Indicator	Period	Consensus		Previous data	
				m/m (q/q)	y/y	m/m (q/q)	y/y
OVERSEAS							
MONDAY 9							
Germany	2:00	Industrial production	Nov.	0.2%	0.1%	-0.1%	0.0%
France	2:45	Trade balance (€M)	Nov.	n/a		-12,150	
France	2:45	Current account (€B)	Nov.	n/a		-3.8	
Italy	4:00	Unemployment rate	Nov.		7.8%		7.8%
Euro zone	5:00	Unemployment rate	Nov.		6.5%		6.5%
Japan	18:30	Consumer price index – Tokyo	Dec.		3.8%		4.0%
TUESDAY 10							
France	2:45	Consumer price index – final	Dec.	-0.1%	5.9%	-0.1%	5.9%
WEDNESDAY 11							
Japan	00:00	Leading indicator – preliminary	Nov.	97.6		98.6	
Japan	00:00	Coincident indicator – preliminary	Nov.	99.1		99.6	
Italy	2:00	Retail sales	Nov.	n/a	n/a	-0.4%	1.3%
Japan	18:50	Current account (¥B)	Nov.	657.5		-609.4	
Japan	18:50	Trade balance (¥B)	Nov.	-1,647.0		-1,875.4	
THURSDAY 12							
Germany	---	Current account (€B)	Nov.	n/a		5.9	
FRIDAY 13							
United Kingdom	2:00	Monthly GDP	Nov.	-0.3%		0.5%	
United Kingdom	2:00	Industrial production	Nov.	-0.3%	-3.0%	0.0%	-2.4%
United Kingdom	2:00	Index of services	Nov.	-0.1%		0.6%	
United Kingdom	2:00	Construction	Nov.	-0.3%	5.4%	0.8%	7.4%
United Kingdom	2:00	Trade balance (£M)	Nov.	-2,100		-1,785	
France	2:45	Industrial production	Nov.	0.9%	-1.0%	-2.6%	-2.7%
Germany	4:00	Annual GDP	2022		1.8%		2.6%
Italy	4:00	Industrial production	Nov.	0.3%	n/a	-1.0%	-1.6%
Euro zone	5:00	Industrial production	Nov.	0.5%	0.5%	-2.0%	3.4%
Euro zone	5:00	Trade balance (€B)	Nov.	-20.0		-28.3	

NOTE: In contrast to the situation in Canada and the United States, disclosure of overseas economic figures is much more approximate. The day of publication is therefore shown for information purposes only. The abbreviations m/m, q/q and y/y correspond to monthly, quarterly and yearly variation respectively. The times shown are Eastern Standard Time (GMT - 5 hours).