Recession risk-- a topic that's been increasingly in the headlines. But our next guest says this constant fretting about slowing growth could become a self-fulfilling prophecy. Joining us now is Beata Caranci, Chief Economist with TD Bank. Great to have you on the program. And let's dive right into it. I'm guilty of this kind of negative thinking too, right? Hey, this is going good, this is going, this is going good, but what about this? What do we make of all this recession chatter? Well, markets are pretty much split, as are surveys. So it's high. It's roughly priced at 50% of that outcome for recession-- not for this year, for next year, possibly even 2024. That's both Canada and the US. However, if you look at the data, there's nothing in the data at this point to suggest it's there. So these are true projections of based on concepts around policy error by the central banks tightening too fast, too high. The general belief that in order to tap down inflation, you need the unemployment rate to rise, and by extension, it would be nice if you can get it to only rise where you want it to rise. But that's not how businesses operate. So there's a lot of diversity of opinion on this front. 50% odds of recession is high, though, in terms of normally in an expansion period, you would see that sitting around 20% to 30%. So we're definitely on a bit of an outlier move right now. And then in terms of the negative headlines, it's well advertised when companies are laying off individuals. We've seen headlines on Netflix, Shopify, Amazon, Walmart, even-- very few companies advertise when they're hiring, often for competitive reasons, especially when you're in a tight labor market, you don't advertise it. But the reality is when you look at the data, especially in the case of the US where we have metrics where we could track, layoffs and separations, which is what it's called, is actually still at a record low. And so it's not apparent that while you have some high profile companies who are adjusting what they're doing based on past patterns and their forecasts going forward, it's not pervasive. Over 90% of industries are still in hiring mode. So when you head towards a recession, that has to get below 60% as a leading indicator for several months out. And so we're nowhere near that mark. So this is the debate happening in the markets between the negative media headlines versus the reality of the data. So the 50/50, obviously, odds-- that's a coin flip, a coin toss. You're saying the data isn't really reflecting all that much in terms of recession risk. So let's get back to this idea of the self-fulfilling prophecy, because in the end, when we're talking about GDP in these big technical terms, it's simply our activity as consumers and how the economy is progressing. And then if we fear the worst, sometimes the worst is just going to show up for us, isn't it? Yeah, and this is what-- we're getting an inkling of this happening in the US, at least on the consumer side. So we had always anticipated that consumer spending would slow towards 1%, 1.5%. But we thought it would be something that would transpire in the second half of this year. And in fact, we saw it come through in the first half. Now, higher inflation was partly a factor, but it wasn't at the levels we see today. And interest rates weren't at the levels we see today. And savings were much higher than we see today. So what was happening? Well, it probably an element of psychology that was coming into play, where people start to get a bit more conservative on the anticipation of what they're hearing around the risk. So definitely we see some consumer caution happening in the US. And that is actually elevating some of the chatter around recession. Because if the consumer capitulates, it's game over. They are 70% of the economy. And then, obviously, businesses would have to respond through layoffs to adjust their business models. We are not seeing the same in Canada. Consumers are extremely resilient, or stubborn, or however you want to put it-- still spending, still out there. One of the reasons that people cite is because there is a delayed opening in Canada relative to what we saw in the US. I would say that would have been true initially. The fact that we continue to see a fair bit of resilience is probably less so. And also what we're not seeing in Canada that we're seeing in the US is the drawdown in savings. So Canadian households are holding on to more of their savings than they are in the US, suggesting that they may have a little bit more running speed still to go. So we do think that momentum is going to slow. It's inevitable with high interest rates and inflation. But it's taking longer to make its way into the psychology of the Canadian consumer. Right. So as we're talking about the economy, since we're talking about GDP, you brought along some charts for us to take a look at. So let's start showing them to the audience in terms of what this is telling us. Because, simply, every dollar that I spend in the economy becomes income for someone else. These two lines aren't on top of each other like they used to be. What's this telling us? BEATA CARANCI: Yeah, so GDP is the expenditure, which you're mentioning-- the expenditure side of measurement of the economy. GDI is gross domestic income. So to your point, every spend is someone else's income. So it's just two ways of measuring the same concept. They are at a historic gap. We've never seen this degree of divergence in this metric. And so that's significant in that one of them is not telling us the right picture. And so as you know, GDP-- this is US data, by the way-- GDP in the US contracted in the first half of the year. What the GDI indicator is telling us is that might be overstating the degree of weakness. And again, we all know that during the pandemic, we've had a lot of measurement issues happening in data, whether it's jobs, GDP, trade, inventories. So it's likely we're getting some of that coming through here. This eventually

will reconcile. There's the history of what the divergences normally look like between these two measures and how historically high we are. OK, our second chart is-- let's show the audience and explain this one as well, because here we have GDP and GDI again, but a bit of a different picture. BEATA CARANCI: Yeah so this is showing you the magnitude of the gaps along the long history-- so you can really see how much of an outlier it is historic. So I would use this graph to basically say, listen, we know the US economy was slowing in the first half of the year. Was it as weak as it was portrayed statistically? Probably not, based on what the GDI is telling us. And what typically forecasters do to get a better sense of where the data really sat, very simple average between the GDP and GDI-- so we had a slowdown but nothing of the magnitude that we saw. So this will get self-corrected over time as revisions come through the data. But there's not a strong argument that the US was in recession in the first half of the year anyway given the job market, but this is one of those other reinforcing factors. I like that approach, right? Here's this view, here's this view, the truth usually lies somewhere in the middle. We got another chart for the audience. This is about business confidence, right? Especially small business, because we always forget that as much as you mentioned before, we talk about these big companies, those are real drivers of employment. So explain to me what we're seeing here in terms of how businesses feel about the economy over time. BEATA CARANCI: Yes. Again, this is a US indicator. So we're always kind of paying attention to the US indicators as a leading indicator where Canada may end up being versus the other way around. So this is from the NFIB, which is a small business sentiment indicator. Obviously, small businesses make up the majority of corporations in the US, of businesses, and as well as in Canada. So this is a sentiment that tells you, are you looking to hire? Are you worried about labor supply? Are you worried about input prices? Things like that. And you can see it's extremely, extremely low relative to its own history, which right away raises a flag that, do we need to be worried that small businesses are going to start cutting back on hiring, which will naturally become self-fulfilling in the evolution of the economy? And what we've done here is we've highlighted in the cycle where you have Democrats versus Republican-- INTERVIEWER: The line changes color over the years, doesn't it? BEATA CARANCI: Yeah. And so the Republicans are in red and Democrats are in blue. And what we notice is that in small business sentiment, when there is a Republican leadership, you have a more optimistic view on the economy, irrespective of the state of the economy. And that's because Republicans tend to be more favorable on the tax and regulatory side, or the perception that they are. And then in terms of Democrats, you can see during the Obama years, you had negative sentiment throughout, and yet it was marked as one of the longest expansions we've had in history. So it's not the best indicator when you're looking to gauge what are the indicators telling us about recession odds. This one, which is called a soft indicator because of sentiment, it's not in my go-to playbook that we should be looking at. And so I would downplay it. If I were to look at a soft indicator, I would instead focus on something like consumer confidence by the conference board. And there's two parts to that. One is they let you know what the current conditions are versus expectations. And I think your instinct would say, well, I'll look at the expectations because that tells me what they're going to do in the future as an indicator of whether we're going to move towards recession. It's opposite. It's their current sentiment that actually gives you the better indicator of how close you're getting to a recession. And that has actually been quite stable. People feel better about right now as opposed to what they're hearing or what they expect in the future. And so that's also not yet giving us a recession signal. It can give you a recession signal up to six months in advance, so we're not even yet at that threshold.

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