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So let's tackle the big question first. I saw a note from your team in recent days about, you can't turn around without having that kind of recession chatter, and people sort of baking it in. But perhaps, are we seeing any signs yet that that's a done deal, or could we escape that?

No, I think the challenge is that, especially in the case of the US right now, there's too much resilience in the economy, and especially inside the job market. And so you can't really cool down wage and inflationary pressures without the job market cooling down, hence central bankers always talking about a bit of pain to be felt in the coming year.

So that's going to be a challenge. And so recession calls are really forecasts. They are not based on current data or evidence in the data today.

And by that token, you get a lot of distribution in terms of timing. Some people saying, oh, Q1, Q2, Q3-- literally. It's spread across every quarter, depending on the forecaster. Where you don't get a lot of differences is in the depth. Many still view it as something that should be mild as a recession is. It's not for those who lose their jobs. But they're not perceiving it to be deep, so something like a 2001 experience.

If we just get a skimming of the surface, we slow down the economy enough to bring down inflation, will that be enough to bring down inflation? I think the reason why people keep saying, oh, there's definitely going to be a recession is because you're not going to get inflation back down around that 2% target over time unless you inflict that kind of pain.

Yeah, and then that goes to the question of what is driving inflation. And even there, there's not a strong consensus. Some people still view that the supply side factors related to the war and the legacy of the pandemic is still out there. As an example, if you look at new vehicle cars, there is still a backlog of production happening, with people ordering their car this year, not getting it till next year. So there's still a legacy impact coming through.

On the flip side, you're seeing used prices for cars come down pretty hard in the last few months, as some of that rotation happens. So the big question is, how much of a slowdown do you need to affect the domestic drivers, like on things like clothing and everything else? And that's where it's perceived to be, well, we don't really need a hard, hard landing to get those drivers to kick in.

But at the end of the day, you do need wage growth to get down to about 3%, to get inflation down to about 2%. That's around the correlation. We're a couple points off from that right now. So it does suggest you have to inflict some pain in the job market.

We did get a fresh read on an inflation in this country just today. Of course, we just got one for the Americans last week. It appears we're headed in the right direction, but we're not apparently in a rush to get there. This feels like this fight's going to take some time.

Yeah, yeah. It's very sticky, and that's the nature of inflation. And policy does work with legs, as everybody now knows. So I think we won't really see significant movements probably until mid of next year, towards the second half of next year. And that's because we need the domestic demand drivers to slow down fast enough for that to pass through the inflation drivers.

And I also think the battle is really not with inflation getting into the 3% to 4% range. It's probably going to be to get in the 2% to 3% range. That's going to be the hard-fought territory, and that's where it depends how much of a soft landing you have to have to get that outcome.

Now, of course, you know better than I do, so correct me if I'm wrong, but I think your team's call is we're going to get one more rate hike and one of those regular 25 basis points--

Imagine.

Yeah, imagine that, that we became so accustomed to. And then they'll be done. But done doesn't mean a reversal in policy. We're going to have to stay there for a while to keep waging this fight.

Yeah. So for-- so that's the Bank of Canada call of getting to about 4.5%. Now, we did build in cuts in the fourth quarter, and that's because-- fourth quarter of next year. And that's because the debt service ratio of Canadians, the proportion of income that they're dedicating to paying interest, is going to be at a historic high.

And every quarter that rolls in, more and more people are going to be renewing their mortgages at this higher level and eating up their disposable income, which means you're not going to be able to spend in other areas. And so that's the dynamic that we're anticipating in Canada to really drive down consumer spending into contraction territory for Canada, that we think will allow the Bank of Canada to step back a little bit and put some relief in.

Having said that, if you're at 4.5% and you drop rates to 3.5%, 3.75%, that is still high relative to what the Bank of Canada deems the neutral rate, the rate that the economy is in that Goldilocks phase. So you're still in restrictive territory. It's not as if it's going to feel that great at that stage.

Is our debt sensitivity in this country a wild card for us? If things play out the way we think they're going to play it, of course, it makes a lot of sense that, as we start to renew mortgages, or people with floating rates have already seen it, and by the time we get to the end of the cycle, it's like, wow, my floating rate mortgage got more than 400 basis points in the course of a year. Is the wild card that that hits harder than we're anticipating for those households?

Yeah. It's a big wild card for Canada. It's not for the US. It's because we haven't really gone through a deleverage cycle in quite some time, going all the way back to the '80s. So the US had this experience in 2008 and 2009, and what we could observe from them is it's not a quick experience. It does last for several years, in terms of not just cautiousness on consumer spending, but the recovery of the psychology of housing.

And so we don't know if Canadians are going to be reacting in the same way. And we also know that the leverage today is higher than what you saw in the US during that crisis. Now, the underwriting of the loans is significantly better. Nothing to compare there. However, at the end of the day, people are going to have to extend on amortizations, pay more money on their debt. That's going to take away from the consumer cycle, and we don't really have a good historical gauge of what that's going to look like.

We mentioned pain a bit earlier. I want to get a bit more into that topic, because it's sort of fascinating to me in the sense that central bankers have said, look what we're doing, trying to tame inflation, it's all necessary, there's going to be some pain. Going to be some pain. For some people are probably starting to feel it, but once the full onslaught of that pain hits, what does that look like for the Canadian household? What does it look like for the Canadian economy?

To me, I think of it really-- bucketed in two areas. One is the share of your income dedicated to paying for debt, which is fine if you say, oh, I have got extra disposable income. I have extra savings, and so you dedicate that savings to that payment. That's not the majority. Many people will have to be making a sacrifice in other areas of spending. So that's a direct impact.

The other impact is what happens to the job market in an environment where you have very high interest rates, and this deliberate braking of the economy in terms of hitting the brakes. And so we anticipate in our forecast about 100,000 job losses. However, it could be more, because we're not quite certain about these dynamics on the debt service ratio and how households absorb it.

And the one factor that Canada has, in terms of elevated risks, is that we had a lot of job hiring coming out of the pandemic. More so than what you saw in the US. Which might say, oh, great, there's higher incomes across the country. But at the same time, it may mean that firms do more on scaling back workers because it's not as lean. The labor market is not as lean as what you're looking at in the US, where employers may be more incented to hoard and to hold on to labor. We've seen more movement on that side in Canada, so it's a bit of a risk in an odd way. [AUDIO LOGO]

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