TD Economics

Quarterly Economic Forecast
The Fog of War

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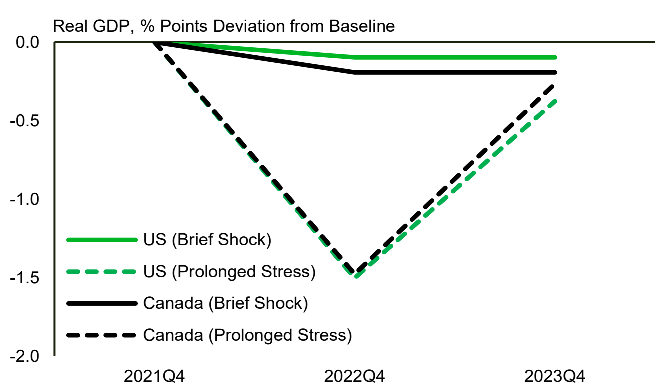
This economic outlook update takes place amidst heavy uncertainty brought on by the Russian invasion of Ukraine. The longer the duration and escalation, the greater the downside risks that build to the global and U.S. outlook.

We will only know with hindsight whether current risk premiums within financial and commodity markets will be validated, prove too optimistic or too cautious. This means that every forecast must be grounded with base assumptions that will need to evolve with geopolitical events. Our starting point assumes that the current elevated risk premia manifested in credit spreads and commodity prices remains in place through March and April. As a result, we expect WTI spot pricing to average $110 a barrel through the second quarter, marking a substantial revision relative to the pre-war forecast of $72 a barrel. Other energy prices, such as natural gas should also remain elevated, though the regional nature of supply means that North American prices will not follow Europe. Other areas where Russian and Ukrainian supply have influence, such as wheat, aluminum, and nickel, are expected to increase another 10% in the second quarter.

While the fog of war has elevated downside risks, market pricing on commodities is currently reflecting a combination of fundamentals related to current and potential supply mismatch, as well as a significant risk premium for the still-to-be-determined impacts. The latter creates significant volatility with two-sided risks. For instance, oil prices can quickly recalibrate lower on a positive sentiment shift if some OPEC members (mainly Saudi Arabia, UAW) even hint at commitments of higher production levels. The price of WTI oil swung from $130 a barrel to $104 within one trading day – landing it not far from its pre-war price that hovered at $90.

Chart 1: War in Eastern Europe Could Weaken Growth in North America



Source: Oxford Economics, TD Economics.

Still, the shock to commodity prices, even if it proves short-lived, will result in much higher near-term inflation. When combined with the likelihood of longer-term sanctions on Russia, this can leave prices at structurally higher end-points this year due to lags in reorienting supply chains, particularly against a backdrop where the American economy is already in excess demand. The net effect will weigh on real disposable income and take some steam out of consumption, particularly in Europe. Fiscal supports are already being announced within various economies to provide some relief to households and businesses. But, this is a double-edged sword. The extent to which these supports are broad across incomes and households may delay or limit the needed demand shifts that would ease pressure on key commodity markets with supply shortfalls. Likewise, this could have the unintended impact of maintaining higher inflation patterns than in the counterfactual outcome, creating an even thinner tightrope for central banks to walk along.

Amid all of this, the Covid-19 pandemic is still a factor on the outlook. Economic re-opening offers a fillip to activity, especially within the service-sector in economies moving away from restrictions. The American job market is maintaining extraordinary momentum. This offers a strong backdrop to absorb the confidence and price pressures emanating from geopolitical risks.

This will keep central banks in tightening mode, at least for the next few meetings, since they are starting on a backfoot to withdraw emergency-level policy supports. The Federal Reserve raised its policy rate in March and is expected to bring the federal funds rate to 1.75% by year's end. The path of rate hikes is more uncertain and highly dependent on the evolution of financial conditions and their impact on economic activity.

This publication focuses on the numbers, but if you'd like a deeper dive into underlying issues, including the impact of the war in Ukraine, please see our Question & Answer piece published February 23rd.

Global

- Compared to our December forecast, we have marked down global growth 0.8 percentage points, taking it to 3.9% (from 4.7% previously) in 2022. The outlook for 2023 has been eased slightly to 3.4% from 3.7%.
- The war in Ukraine and accompanying shock to energy, food and other commodity prices is the main factor behind the downgrade to the European outlook. Softer growth through the winter months amid the spread of the Omicron COVID-19 variant has also weighed on the handoff for 2022.
- Energy and wheat prices have surged in response to the conflict in Ukraine, adding fuel to the inflationary fire. Moreover, sanctions on Russia and export controls add another layer of disruptions to global supply chains. European economies will face the brunt of the economic effects, but the shock is sure to reverberate around the world.
- However, there are already signs that governments will try to cushion the impacts. This adds an element of upside uncertainty to the downgraded outlook via the potential for large fiscal responses among E.U. member states. Roughly 200 billion euros from the E.U.'s Recovery and Resiliency Facility remain available for potential deployment to households and businesses, while other countries, like Germany, have already announced substantial increases in defense spending. The impacts of both initiatives would lag relative to the immediate shock underway but begin to manifest by the second half of the year.
- Among emerging markets (EMs), food is significant share of the consumer basket. The sharp move higher in food prices will cut deeply into real disposable income and dent domestic demand. Moreover, higher inflation and the associated rate hikes in advanced economies could lead to capital outflows, putting currencies under pressure and further increasing borrowing costs. That said, commodity exporters will benefit from both higher prices and potentially new customers as purchasers seek to limit exposure to Russia.

United States

- After the strongest annual average growth in nearly 40 years (5.7%) in 2021, U.S. economic growth has shown clear signs of slowing at the outset of 2022. Real GDP growth in the first quarter of 2022 looks to come in close to stall speed (0.6% annualized). Underneath the surface, domestic demand – spending by American households and businesses continues to grow at an above trend rate, but supply chain challenges and weak foreign activity are weighing on economic growth.
- Inflation, which had already risen to worrisome levels, will move even higher because of the war in Ukraine. Higher food and energy prices will reduce consumer's purchasing power and slow growth in personal consumption expenditures – the biggest component of GDP – this year.

- The good news is that the labor market has continued to perform very well, with job growth surprising to the upside and showing little signs of deceleration in recent months. Labor demand is looking strong, with job openings still at very high levels. We expect continued hiring o push the unemployment rate lower, moving below its 3.5% pre-pandemic low. A recent increase in the labor force participation rate is another source for optimism, indicating that the scaring that occurred because of the pandemic may finally be healing.
- Business investment is another bright spot, accelerating at the outset of the year and likely to remain healthy over the course of this year. High energy prices will be a boon to American energy producers who are likely to increase investment to raise production.
- Overall, we expect solid annual average economic growth of 3.2% in 2022, slowing to 2.5% in 2023.

Financial

- Following its hike in March, the Federal Reserve is likely to opt for a 50 basis point hike at its next meeting, and follow with three more rate hikes this year, pushing the fed funds rate to 1.75% by the end of 2022 and 2.25% by the middle of 2023.
- It's natural to wonder how the Ukraine war might alter the path. Fewer rate hikes would likely require evidence of a much slower domestic growth pattern taking hold due to the erosion in financial conditions and sentiment. Worrying signs of financial contagion can also do the trick. Likewise, should geopolitical risk premiums recede and inflation stay elevated, the central bank would opt to speed up the rate normalization timeframe.
- Federal Open Market Committee members have signalled higher rate expectations than we have pencilled in, but we suspect this is to anchor market inflation expectations. The Fed could run the risk of moving too fast and too far given they are on the backfoot with inflation and have indicated an intention to also reduce the size of their balance sheet.
- Expectations for rising policy rates, the start of Quantitative Tightening (QT), and elevated inflation should continue to push up government bond yields. This is already evident at the short and long end of the curve, but this normalization process remains incomplete. The 10-year yield should not just cross the 2% threshold (as already evidenced) but continue to edge up as the year progresses.
- As time passes and war risk sentiment recedes, the U.S. dollar may give up some of its recent gains. There is room for the euro and pound to appreciate, as these currencies are trading below long-term fair value. We are less optimistic on EM currencies relative to the USD, given weakness in their respective economic recoveries.

U.S. Economic Outlook

Period-Over-Period Annualized Per Cent Change Unless Otherwise Indicated

Economic Indicators	2021				2022				2023				Annual Average			4th Qtr/4th Qtr		
	Q1	Q2	Q3	Q4	Q1F	Q2F	Q3F	Q4F	Q1F	Q2F	Q3F	Q4F	21	22F	23F	21	22F	23F
Real GDP	6.3	6.7	2.3	7.0	0.6	3.2	2.3	2.9	2.4	2.3	2.0	2.1	5.7	3.2	2.5	5.6	2.3	2.2
Consumer Expenditure	11.4	12.0	2.0	3.1	2.4	2.5	1.3	2.1	2.4	2.5	2.6	2.5	7.9	2.9	2.3	7.0	2.1	2.5
Durable Goods	50.0	11.6	-24.6	2.7	8.5	-3.4	-7.2	-1.3	1.6	2.8	3.7	4.0	18.1	-2.0	0.2	6.7	-1.0	3.0
Business Investment	12.9	9.2	1.6	3.1	10.1	7.9	3.6	3.8	3.8	3.3	3.2	2.9	7.4	6.0	3.8	6.6	6.3	3.3
Non-Res. Structures	5.4	-3.0	-4.1	-9.4	-0.6	0.7	6.1	3.6	3.4	3.2	3.0	3.0	-8.1	-1.6	3.5	-2.9	2.4	3.1
Equipment & IPP*	14.8	12.3	3.0	6.3	12.7	9.6	3.1	3.8	3.9	3.4	3.2	2.9	11.6	7.9	3.9	9.0	7.2	3.4
Residential Investment	13.3	-11.7	-7.7	1.0	2.6	1.3	-2.0	-3.3	-1.7	0.2	1.0	1.5	9.1	-1.2	-1.0	-1.7	-0.4	0.2
Govt. Expenditure	4.2	-2.0	0.9	-2.6	0.1	1.3	0.8	0.9	1.2	1.3	0.9	1.2	0.5	-0.1	1.1	0.1	0.8	1.1
Final Domestic Demand	10.4	8.0	1.3	2.0	3.0	2.9	1.4	1.9	2.2	2.3	2.3	2.3	6.6	2.6	2.1	5.4	2.3	2.3
Exports	-2.9	7.6	-5.3	23.6	-0.8	9.3	5.9	5.4	5.2	4.2	3.3	3.5	4.6	6.4	5.0	5.2	4.9	4.0
Imports	9.3	7.1	4.7	17.6	7.2	5.3	0.4	-1.5	2.3	3.0	3.8	3.3	14.0	6.9	1.9	9.6	2.8	3.1
Change in Private Inventories	-88.3	-168.5	-66.8	171.2	116.4	117.4	130.5	135.6	131.3	128.0	121.5	115.3	-38.1	125.0	124.0	--	--	--
Final Sales	9.1	8.1	0.1	2.0	1.9	3.2	2.0	2.8	2.5	2.4	2.2	2.3	5.4	2.4	2.5	4.7	2.5	2.3
International Current Account Balance ($Bn)	-758	-793	-859	-841	-935	-935	-884	-808	-750	-715	-694	-677	-813	-890	-709	--	--	--
% of GDP	-3.4	-3.5	-3.7	-3.5	-3.8	-3.7	-3.5	-3.1	-2.9	-2.7	-2.6	-2.5	-3.5	-3.5	-2.7	--	--	--
Pre-tax Corporate Profits including IVA&CCA	22.0	49.1	14.5	-7.7	-3.9	11.0	5.8	1.3	4.8	6.8	4.3	2.7	24.2	4.4	4.8	17.7	3.4	4.6
% of GDP	11.6	12.4	12.6	11.9	11.6	11.6	11.6	11.5	11.5	11.5	11.5	11.5	12.1	11.6	11.5	--	--	--
GDP Deflator (y/y)	2.1	4.1	4.6	5.9	6.5	6.5	6.0	4.9	3.9	3.1	2.7	2.6	4.2	5.9	3.0	5.9	4.9	2.6
Nominal GDP	10.9	13.4	8.4	14.6	6.9	9.5	6.4	5.8	5.1	5.1	4.7	4.6	10.1	9.2	5.6	11.8	7.1	4.9
Labor Force	-0.7	1.4	1.2	1.4	4.9	1.4	1.5	1.6	1.3	1.1	0.8	0.7	0.3	2.3	1.2	0.8	2.4	1.0
Employment	3.6	4.1	4.8	4.9	4.9	2.5	2.0	2.0	1.7	0.9	0.6	0.5	2.8	3.8	1.5	4.3	2.8	0.9
Change in Empl. ('000s)	1262	1453	1695	1759	1790	938	756	738	629	340	242	199	3957	5586	2221	6169	4222	1410
Unemployment Rate (%)	6.2	5.9	5.1	4.2	3.8	3.6	3.5	3.4	3.4	3.5	3.5	3.6	5.4	3.6	3.5	--	--	--
Personal Disp. Income	60.6	-24.5	1.0	0.4	2.0	5.7	6.1	4.6	6.9	5.6	6.0	5.8	6.1	1.0	5.9	5.3	4.6	6.1
Pers. Savings Rate (%)	20.5	10.9	9.5	7.6	5.9	5.1	5.3	5.4	5.9	6.2	6.5	6.8	12.1	5.4	6.4	--	--	--
Cons. Price Index (y/y)	1.9	4.8	5.3	6.7	8.0	7.9	6.9	5.2	3.5	2.1	2.0	2.1	4.7	7.0	2.4	6.7	5.2	2.1
Core CPI (y/y)	1.4	3.7	4.1	5.0	6.3	5.6	5.4	4.8	3.8	3.3	2.8	2.7	3.6	5.5	3.1	5.0	4.8	2.7
Core PCE Price Index (y/y)	1.7	3.4	3.6	4.6	5.4	5.1	5.0	4.5	3.6	3.0	2.6	2.4	3.3	5.0	2.9	4.6	4.5	2.4
Housing Starts (mns)	1.60	1.59	1.56	1.65	1.66	1.59	1.56	1.54	1.53	1.56	1.57	1.57	1.60	1.59	1.56	--	--	--
Real Output per hour (y/y)**	3.8	2.1	-0.4	1.9	0.5	-0.2	1.0	-0.4	0.8	1.2	1.6	1.8	1.8	0.2	1.3	1.9	-0.4	1.8

F: Forecast by TD Economics as at March 2022.

* Intellectual Property Products. ** Non-farm business sector.

Source: Bureau of Labor Statistics, Bureau of Economic Analysis, Census Bureau, TD Economics.

Interest Rate Outlook												
Interest Rates	**2021**				**2022**				**2023**			
	Q1	**Q2**	**Q3**	**Q4**	**Q1F**	**Q2F**	**Q3F**	**Q4F**	**Q1F**	**Q2F**	**Q3F**	**Q4F**
Fed Funds Target Rate	0.25	0.25	0.25	0.25	0.50	1.25	1.50	1.75	2.00	2.25	2.25	2.25
3-mth T-Bill Rate	0.03	0.05	0.04	0.06	0.80	1.30	1.55	1.75	2.00	2.15	2.15	2.15
2-yr Govt. Bond Yield	0.16	0.25	0.28	0.73	1.80	1.95	2.00	2.05	2.05	2.05	2.00	2.00
5-yr Govt. Bond Yield	0.92	0.87	0.98	1.26	2.00	2.10	2.20	2.25	2.30	2.25	2.20	2.15
10-yr Govt. Bond Yield	1.74	1.45	1.52	1.52	2.15	2.25	2.35	2.40	2.45	2.40	2.35	2.30
30-yr Govt. Bond Yield	2.41	2.06	2.08	1.90	2.45	2.55	2.65	2.70	2.75	2.70	2.65	2.60
10-yr-2-yr Govt Spread	1.58	1.20	1.24	0.79	0.35	0.30	0.35	0.35	0.40	0.35	0.35	0.30

F: Forecast by TD Economics as at March 2022. All forecasts are end-of-period.

Source: Bloomberg, Federal Reserve, TD Economics.

Foreign Exchange Outlook													
Currency	**Exchange rate**	**2021**				**2022**				**2023**			
		Q1	**Q2**	**Q3**	**Q4**	**Q1F**	**Q2F**	**Q3F**	**Q4F**	**Q1F**	**Q2F**	**Q3F**	**Q4F**
Euro	USD per EUR	1.17	1.19	1.16	1.13	1.10	1.09	1.10	1.11	1.13	1.15	1.16	1.18
UK pound	USD per GBP	1.38	1.38	1.35	1.35	1.31	1.32	1.34	1.36	1.38	1.38	1.39	1.39
Australian dollar	USD per AUD	0.76	0.75	0.72	0.72	0.73	0.72	0.72	0.72	0.73	0.73	0.74	0.74
NZ dollar	USD per NZD	0.70	0.70	0.69	0.68	0.69	0.68	0.68	0.68	0.69	0.69	0.69	0.70
Canadian dollar	CAD per USD	1.26	1.24	1.27	1.28	1.27	1.26	1.25	1.25	1.25	1.25	1.25	1.25
Swiss franc	CHF per USD	0.94	0.93	0.93	0.92	0.94	0.95	0.96	0.97	0.98	0.99	1.00	1.01
Japanese yen	JPY per USD	111	111	112	115	118	112	108	107	106	105	104	103
Chinese renminbi	CNY per USD	6.55	6.46	6.44	6.36	6.35	6.40	6.45	6.50	6.55	6.60	6.65	6.70

F: Forecast by TD Economics as at March 2022. All forecasts are end-of-period.

Source: Bloomberg, Federal Reserve, TD Economics.

Commodity Price Outlook												
Commodity	**2021**				**2022**				**2023**			
	Q1	**Q2**	**Q3**	**Q4**	**Q1F**	**Q2F**	**Q3F**	**Q4F**	**Q1F**	**Q2F**	**Q3F**	**Q4F**
Crude Oil (WTI, $US/bbl)	58	66	71	77	95	110	100	90	85	80	76	73
Natural Gas ($US/MMBtu)	3.56	2.94	4.36	4.77	4.50	4.60	4.40	4.20	4.00	3.80	3.60	3.50
Gold ($US/troy oz.)	1796	1815	1790	1796	1862	1900	1850	1800	1809	1818	1827	1836
Silver ($US/troy oz.)	26.25	26.71	24.30	23.35	23.82	25.00	24.00	23.00	23.12	23.23	23.35	23.46
Copper (cents/lb)	385	439	425	440	450	500	450	425	427	429	431	434
Nickel ($US/lb)	7.97	7.86	8.67	8.99	10.89	11.50	11.00	10.50	10.55	10.61	10.66	10.71
Aluminum (cents/lb)	95	109	120	125	146	160	150	120	121	121	122	122
Wheat ($US/bu)	7.41	8.53	10.27	11.44	11.37	13.00	12.00	11.00	11.06	11.11	11.17	11.22

F: Forecast by TD Economics as at March 2022. All forecasts are period averages.

Source: Bloomberg, TD Economics, USDA (Haver).

Economic Indicators: G7 & Europe				
	2020	2021	2022F	2023F
Real GDP (annual per cent change)				
G7 (30.1%)*	-5.0	5.1	3.3	2.3
U.S.	-3.4	5.7	3.2	2.5
Japan	-4.5	1.6	2.8	1.5
Euro Area	-6.5	5.2	3.4	2.3
Germany	-4.9	2.8	3.2	2.8
France	-8.0	7.0	3.3	1.9
Italy	-9.0	6.5	3.2	1.7
United Kingdom	-9.4	7.2	4.0	2.1
Canada	-5.2	4.6	3.9	3.0
Consumer Price Index (annual per cent change)				
G7	0.8	3.3	5.8	1.9
U.S.	1.2	4.7	7.0	2.4
Japan	0.0	-0.2	1.5	0.7
Euro Area	0.3	2.6	5.2	1.5
Germany	0.4	3.2	5.3	1.4
France	0.5	2.1	4.4	1.3
Italy	-0.1	1.9	5.8	1.4
United Kingdom	0.9	2.6	7.2	2.2
Canada	0.7	3.4	5.0	2.1
Unemployment Rate (per cent annual averages)				
U.S.	8.1	5.4	3.6	3.5
Japan	2.8	2.8	2.9	2.5
Euro Area	8.0	7.7	7.5	7.4
Germany	5.9	5.7	5.2	5.0
France	8.0	7.9	7.6	7.6
Italy	9.3	9.5	9.2	9.0
United Kingdom	4.5	4.5	4.3	4.0
Canada	9.6	7.4	5.4	5.4

*Share of 2019 world gross domestic product (GDP) at PPP.
Forecast as at March 2022.
Source: National statistics agencies, TD Economics.

Global Economic Outlook				
Annual Per Cent Change Unless Otherwise Indicated				
	2019 Share*	Forecast		
Real GDP	**(%)**	**2021**	**2022**	**2023**
World	100.0	6.0	3.9	3.4
North America	19.2	5.5	3.1	2.5
United States	15.8	5.7	3.2	2.5
Canada	1.4	4.6	3.9	3.0
Mexico	1.9	5.2	2.2	2.3
European Union (EU-28)	15.4	5.2	3.5	2.2
Euro Area (EU-19)	12.5	5.2	3.4	2.3
Germany	3.5	2.8	3.2	2.8
France	2.4	7.0	3.3	1.9
Italy	2.0	6.5	3.2	1.7
United Kingdom	2.4	7.2	4.0	2.1
EU accession members	2.9	5.2	4.1	2.1
Asia	43.2	6.4	4.6	4.7
Japan	4.1	1.6	2.8	1.5
Asian NIC's	3.5	5.2	3.2	2.4
Hong Kong	0.3	6.5	2.0	3.2
Korea	1.7	4.0	3.0	2.5
Singapore	0.4	7.2	4.4	2.4
Taiwan	0.9	6.3	3.6	2.3
Russia	3.1	3.5	-8.0	-0.2
Australia & New Zealand	1.2	4.7	3.6	2.8
Emerging Asia	31.4	7.5	6.2	5.9
ASEAN-5	5.7	3.3	5.7	5.4
China	17.3	8.4	5.4	5.6
India**	7.1	8.7	8.8	7.0
Central/South America	5.6	7.4	2.2	2.3
Brazil	2.4	4.9	0.7	1.7
Other Emerging Markets	13.0	5.5	4.1	2.9
Other Advanced	1.1	4.7	3.7	2.2

*Share of world GDP on a purchasing-power-parity (PPP) basis.
Forecast as at March 2022. **Forecast for India refers to fiscal year.
Source: IMF, TD Economics.