Quarterly Economic Forecast
Stronger for Longer

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2023 has started off on a better-than-expected footing, resulting in an upgraded outlook over the next two years. However, that doesn't mean the braking force from higher interest rates is finished, the peak impacts are yet to be felt and economic momentum is still expected to be sub-par this year. Higher borrowing costs have already sent the housing sector into reverse, and the production side of the economy has started to flatline.

Now, the failure of two U.S. regional banks has brought a new risk on the block. Ahead of next week's FOMC meeting, markets had initially leaned towards a 50-basis point interest rate hike, but that is now off the table, and we agree. Although the Federal Reserve is not one to be responsive to typical market gyrations, this is not a typical event. Investors are still weighing the possibility that others could be waiting in the wings, which ultimately reflects a confidence crisis. The response to shore up that confidence was swift by the Federal Reserve, Treasury and FDIC. Measures included a guarantee on deposits of all amounts and a new bank lending facility to support liquidity tensions. But time will be needed to settle nerves and ensure there will not be other unforeseen contagion effects in other segments of the market.

This week's events ring familiar to the quantitative tightening cycle in 2019, even though the two periods are unrelated. The portion that is "familiar" is that market limits appear in unexpected places when the central bank presses into unprecedented territory. And this ultimately changes the game plan. Back then, the draining of assets from the Fed's balance sheet was going perfectly smoothly, until it wasn't. During September 2019, the Federal Reserve was caught off guard with a sudden need to halt quantitative tightening when strain showed up in money markets under a perceived benign influence. A common seasonal pattern that reflected an overlap of a corporate tax date and an increase in net Treasury issuance subsequently caused sharp upward pressure on money markets – far greater than could be explained by these usual seasonal influences. What should have been a modest strain in money markets faced an amplifier against a backdrop of declining reserves under the Fed's balance sheet normalization process. A threshold was discovered on what the market could tolerate or absorb. Today's events carry a similar theme.

The economy can certainly support higher interest rates – as evidenced by the solid job market and stubborn inflation – but the Fed's unprecedented rapid rate hike cycle has exposed a vulnerability within smaller regional banks and their deposit holdings, as investors seek out higher yielding investments. Until market confidence is fully restored and assured on a longer-term basis that there are no more SVB's lurking, the Fed will prioritize financial stability over the near-term economic data. Due to the timing of publishing our forecast, we have embedded a 25bps hike at the March 22nd meeting under the view that financial markets will settle down between now and then. However, there is no urgency on that rate hike if confidence has not been restored. In fact, if market confidence is undermined over a prolonged period, it will feed into the real economy and negatively impact hiring, investment and spending intentions. This would put an earlier end to the Fed rate hike cycle than they had anticipated.

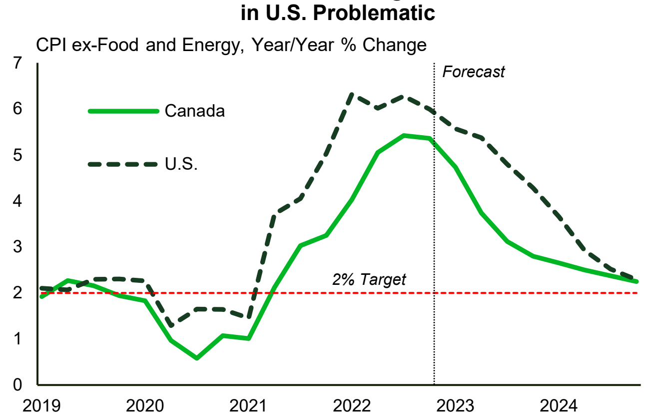
Globally, there's greater confidence that the collection of last year's risks have passed a peak uncertainty period, but there is ample reason for caution to leave a mark on the outlook. Peace seems far away in Russia's war in Ukraine, and the pandemic continues to cast a long shadow on the economic data. Despite a normalization in global supply chains, inventory swings remain outsized and shifting seasonal patterns are contributing to data volatility. Calling a turning point in the data will be difficult and raises the risk that central banks misread the tea leaves.

Global outlook improves as peak uncertainty passes

Two key reasons that peak uncertainty has faded from the global outlook are due to an improvement in energy market conditions in Europe and the end of China's zero-COVID strategy. We still expect global growth to slow from 3.3% in 2022 to 2.8% in 2023, but this is an improvement from our December forecast.

Some of the credit goes to Mother Nature. Unseasonably warm weather in Europe reduced demand for heating and helped the region avoid a worst-case scenario during its energy crisis. While the peak tension period has passed, energy supplies remain a risk. The continent faces the prospect

Chart 1: Core Inflation Cooling, But Persistence in U.S. Problematic



Source: BLS, Statistics Canada, TD Economics.

of higher electricity costs in the summer months due to the increased risk of droughts and with nuclear generating capacity offline for maintenance in France. And, Europe has a huge inflation problem. Falling energy costs have not yet filtered through to core inflation, which is running higher than in North America over the past three months. The European Central Bank is in an earlier phase of its rate hike cycle and further tightening is still necessary to rein in inflation.

China's economic recovery is shaping up to be as impressive as it is quick. So far in 2023, PMI indicators suggest a post-lockdown recovery in demand should provide a healthy boost in the first quarter. However, this lift will be temporary, as the country still contends with a slowdown in the property market. China is deleveraging, which is typically a prolonged process, raising the risk that growth disappoints after the initial spurt. Chinese authorities have set a modest growth target of 5% for 2023, which we suspect they could overshoot, but the opposing forces within the economy mean that any near-term burst of activity should moderate in the latter half of the year.

Global resilience presents a risk to the commodity price outlook. If China outperforms our expectations, there is upside risk to our oil price view and to headline inflation.

Good news is bad news for the U.S. economy

Turning to the U.S., the economy ended 2022 on a solid note with fourth quarter GDP growth advancing 2.7% (annualized). However, that figure was goosed up by a sizeable boost in inventories that masked flat domestic demand. Nothing seems to move in a straight line these days and the first quarter reflects a tug-of-war between sturdy consumer spending and backtracking residential investment. The current quarter is revealing ongoing consumer resiliency, and some upside starting to appear on the residential side of the economy.

All this adds up to another upgrade to economic growth in 2023 and 2024, albeit to a still sub-trend pace of 1.3% and 1.0%, respectively. But, in the current overheated economy, good news is bad news, as it comes alongside an upgrade to our inflation forecast (Chart 1). Core inflationary pressures will not go gently into that good night. January introduced a double hit to market optimism on inflation. The data for the month of January halted a nascent downtrend that had emerged in the three-month annualized measure for core services – a Fed favorite measure of late – and that trend only worsened in February. This was made worse by revisions to the past data that revealed far more persistence. As a result, inflation forecasts were marked up. The Fed's terminal rate would likewise have been lifted closer to the 6% mark if not for caution injected due to the recent failure of two regional banks.

Regardless of recent financial events, the road to lower inflation still runs through the labor market. So long as job vacancies remain elevated, wage gains will continue to run above a level consistent with 2% inflation. There have been some early signs that job openings are coming down in key cyclical sectors like construction, but the data lacks breadth across industries. Hiring has a long way to slow before the Federal Reserve would have comfort that the labor market is moving back into balance. All in, this adds conviction to our view that a slower, more prolonged period of sub-trend economic growth is a more likely outcome than a short recession followed by a return to near-trend growth in the following year. However, no matter the economic trajectory, a rise in the unemployment rate is a consistent theme across forecasters. We estimate the unemployment rate needs to rise by at least 1.2%-pts to normalize job vacancies and restore balance in the labor market.

U.S. Economic Outlook

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

Economic Indicators	2022				2023				2024				Annual Average			4th Qtr/4th Qtr		
	Q1	Q2	Q3	Q4	Q1F	Q2F	Q3F	Q4F	Q1F	Q2F	Q3F	Q4F	22	23F	24F	22	23F	24F
Real GDP	-1.6	-0.6	3.2	2.7	1.0	0.5	0.4	0.7	0.8	1.2	1.6	1.8	2.1	1.3	1.0	0.9	0.6	1.4
Consumer Expenditure	1.3	2.0	2.3	1.4	2.6	1.1	0.1	0.4	0.6	1.0	1.3	1.4	2.8	1.5	0.7	1.8	1.0	1.1
Durable Goods	7.7	-2.8	-0.8	-1.9	3.2	-2.6	-4.6	-2.3	-1.5	0.1	0.6	1.1	-0.5	-1.1	-1.4	0.5	-1.6	0.1
Business Investment	7.9	0.1	6.2	3.3	3.2	1.1	-1.5	-0.2	1.1	1.8	2.3	2.9	3.8	2.1	0.9	4.3	0.6	2.0
Non-Res. Structures	-4.4	-12.7	-3.6	8.5	4.0	0.0	-4.0	-2.3	-1.0	0.0	1.0	3.0	-6.9	0.5	-0.9	-3.3	-0.6	0.7
Equipment & IPP*	11.1	3.4	8.7	2.0	2.9	1.3	-0.9	0.3	1.6	2.3	2.6	2.8	6.6	2.5	1.4	6.2	0.9	2.3
Residential Investment	-3.1	-17.8	-27.1	-25.9	-11.9	-16.5	-5.2	3.2	10.3	11.4	11.5	12.3	-10.7	-16.5	5.6	-19.0	-7.9	11.4
Govt. Expenditure	-2.3	-1.6	3.7	3.6	2.0	0.7	1.9	1.0	1.0	0.9	0.8	0.9	-0.6	2.0	1.0	0.8	1.4	0.9
Final Domestic Demand	1.3	0.2	1.5	0.7	2.0	0.3	0.0	0.5	1.1	1.5	1.7	1.9	1.7	0.9	1.0	0.9	0.7	1.5
Exports	-4.6	13.8	14.6	-1.6	7.0	2.0	0.8	1.1	2.0	2.5	2.8	3.0	7.2	4.5	1.9	5.2	2.7	2.6
Imports	18.4	2.3	-7.3	-4.2	4.0	-2.7	-1.3	1.1	2.0	2.5	2.7	3.3	8.2	-1.2	1.4	1.8	0.2	2.6
Change in Private																		
Inventories	214.5	110.2	38.7	136.3	80.4	61.1	68.3	75.2	66.5	58.0	53.7	53.7	124.9	71.3	58.0	--	--	--
Final Sales	-1.8	1.4	4.5	1.2	2.2	1.0	0.3	0.5	1.0	1.4	1.7	1.8	1.3	1.7	1.0	1.3	1.0	1.5
International Current																		
Account Balance ($Bn)	-1130	-955	-868	-880	-868	-879	-914	-952	-972	-979	-988	-995	-958	-903	-984	--	--	--
% of GDP	-4.6	-3.8	-3.4	-3.4	-3.3	-3.3	-3.4	-3.5	-3.5	-3.5	-3.5	-3.5	-3.8	-3.4	-3.5	--	--	--
Pre-tax Corporate Profits																		
including IVA&CCA	0.5	19.7	-0.2	20.2	-18.5	1.6	-1.4	-1.1	-0.1	2.7	4.5	4.0	8.4	-0.6	1.0	9.6	-5.2	2.8
% of GDP	11.6	11.9	11.7	12.0	11.3	11.2	11.1	10.9	10.9	10.8	10.9	10.9	11.8	11.1	10.9	--	--	--
GDP Deflator (y/y)	6.9	7.6	7.1	6.4	5.3	3.9	3.6	3.4	3.0	2.6	2.3	2.1	7.0	4.0	2.5	6.4	3.4	2.1
Nominal GDP	6.6	8.5	7.7	6.7	5.0	4.1	3.6	3.5	3.2	3.4	3.6	3.8	9.2	5.4	3.5	7.4	4.1	3.5
Labor Force	4.5	0.4	0.9	0.7	3.7	0.5	0.6	0.5	0.5	0.6	0.5	0.5	1.9	1.4	0.5	1.6	1.3	0.6
Employment	4.6	3.2	3.4	2.5	2.5	0.7	-0.5	-0.7	-0.9	-0.7	-0.4	-0.1	4.3	1.8	-0.6	3.4	0.5	-0.5
Change in Empl. ('000s)	1689	1197	1287	955	969	270	-176	-277	-360	-268	-145	-42	6346	2673	-872	5128	786	-815
Unemployment Rate (%)	3.8	3.6	3.5	3.6	3.5	3.5	3.7	3.9	4.2	4.4	4.6	4.7	3.6	3.6	4.5	--	--	--
Personal Disp. Income	-3.9	4.8	7.7	8.6	10.5	5.2	3.7	3.4	4.0	3.3	3.3	3.5	-0.1	7.1	3.7	4.2	5.6	3.5
Pers. Savings Rate (%)	4.3	3.2	3.2	3.9	4.5	4.5	4.4	4.4	4.7	4.8	4.9	5.0	3.7	4.4	4.8	--	--	--
Cons. Price Index (y/y)	8.0	8.6	8.3	7.1	5.9	4.7	4.3	4.0	3.4	2.7	2.1	1.8	8.0	4.7	2.5	7.1	4.0	1.8
Core CPI (y/y)	6.3	6.0	6.3	6.0	5.6	5.4	4.8	4.3	3.7	2.9	2.5	2.3	6.1	5.0	2.8	6.0	4.3	2.3
Core PCE Price Index (y/y)	5.3	5.0	4.9	4.8	4.8	4.7	4.4	4.0	3.2	2.6	2.3	2.1	5.0	4.5	2.5	4.8	4.0	2.1
Housing Starts (mns)	1.72	1.65	1.45	1.41	1.29	1.21	1.20	1.27	1.34	1.37	1.40	1.43	1.56	1.24	1.38	--	--	--
Real Output per hour** (y/y)	-1.0	-2.5	-1.5	-1.8	-1.0	0.0	0.0	-0.1	1.1	1.6	1.8	1.9	-1.7	-0.3	1.6	-1.8	-0.1	1.9

F: Forecast by TD Economics as at March 2023.

* 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	2022				2023				2024			
	Q1	Q2	Q3	Q4	Q1F	Q2F	Q3F	Q4F	Q1F	Q2F	Q3F	Q4F
Fed Funds Target Rate	0.50	1.75	3.25	4.50	5.00	5.25	5.25	5.25	4.75	4.25	3.75	3.25
3-mth T-Bill Rate	0.51	1.66	3.22	4.30	5.05	5.15	5.15	4.90	4.40	3.90	3.40	2.90
2-yr Govt. Bond Yield	2.28	2.92	4.22	4.41	4.30	4.40	4.05	3.70	3.40	3.10	2.85	2.70
5-yr Govt. Bond Yield	2.42	3.01	4.06	3.99	3.80	3.90	3.70	3.55	3.35	3.15	3.05	2.95
10-yr Govt. Bond Yield	2.32	2.98	3.83	3.88	3.60	3.75	3.65	3.50	3.40	3.25	3.15	3.05
30-yr Govt. Bond Yield	2.44	3.14	3.79	3.97	3.75	3.90	3.85	3.80	3.70	3.55	3.45	3.35
10-yr-2-yr Govt Spread	0.04	0.06	-0.39	-0.53	-0.70	-0.65	-0.40	-0.20	0.00	0.15	0.30	0.35

F: Forecast by TD Economics as at March 2023. All forecasts are end-of-period.

Source: Bloomberg, Federal Reserve, TD Economics.

Foreign Exchange Outlook													
Currency	Exchange rate	2022				2023				2024			
		Q1	Q2	Q3	Q4	Q1F	Q2F	Q3F	Q4F	Q1F	Q2F	Q3F	Q4F
Euro	USD per EUR	1.11	1.05	0.98	1.07	1.07	1.06	1.08	1.10	1.13	1.15	1.17	1.19
UK pound	USD per GBP	1.32	1.22	1.11	1.21	1.21	1.20	1.21	1.22	1.24	1.25	1.26	1.27
Australian dollar	USD per AUD	0.75	0.69	0.64	0.68	0.67	0.65	0.66	0.66	0.67	0.68	0.68	0.69
NZ dollar	USD per NZD	0.70	0.63	0.56	0.63	0.62	0.61	0.61	0.62	0.62	0.63	0.64	0.64
Canadian dollar	CAD per USD	1.25	1.29	1.38	1.35	1.37	1.39	1.38	1.36	1.35	1.34	1.32	1.31
Swiss franc	CHF per USD	0.92	0.96	0.98	0.92	0.92	0.92	0.92	0.92	0.92	0.92	0.92	0.92
Japanese yen	JPY per USD	121	136	145	132	135	138	135	130	127	125	124	123
Chinese renminbi	CNY per USD	6.34	6.70	7.11	6.90	6.90	7.00	6.95	6.90	6.85	6.80	6.80	6.80

F: Forecast by TD Economics as at March 2023. All forecasts are end-of-period.

Source: Bloomberg, Federal Reserve, TD Economics.

Commodity Price Outlook												
Commodity	2022				2023				2024			
	Q1	Q2	Q3	Q4	Q1F	Q2F	Q3F	Q4F	Q1F	Q2F	Q3F	Q4F
Crude Oil (WTI, $US/bbl)	94	109	93	83	77	83	89	90	90	89	88	85
Natural Gas ($US/MMBtu)	4.66	7.48	7.99	5.55	2.50	3.00	3.20	3.80	4.20	4.50	4.80	4.75
Gold ($US/troy oz.)	1876	1873	1728	1731	1840	1850	1870	1900	1920	1925	1900	1880
Silver ($US/troy oz.)	24.05	22.66	19.25	21.30	22.30	22.00	22.50	22.80	22.90	23.00	23.04	23.06
Copper (cents/lb)	453	433	352	363	405	406	406	408	411	411	412	414
Nickel ($US/lb)	12.73	13.20	10.00	11.53	12.40	11.50	11.00	10.90	10.80	10.70	10.68	10.65
Aluminum (cents/lb)	148	131	107	105	105	108	109	111	113	115	120	122
Wheat ($US/bu)	11.55	13.69	10.72	11.60	10.80	9.00	8.50	8.40	8.20	8.10	7.90	7.70

F: Forecast by TD Economics as at March 2023. All forecasts are period averages.

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

Economic Indicators: G7 & Europe				
	2021	2022	2023F	2024F
Real GDP (annual per cent change)				
G7 (30.1%)*	5.3	2.3	0.8	0.9
U.S.	5.9	2.1	1.3	1.0
Japan	2.2	1.0	1.1	1.2
Euro Area	5.3	3.5	0.6	0.5
Germany	2.6	1.9	-0.1	0.7
France	6.8	2.6	0.4	0.6
Italy	7.0	3.8	0.4	0.4
United Kingdom	7.6	4.0	-0.5	0.8
Canada	5.0	3.4	0.8	0.4
Consumer Price Index (annual per cent change)				
G7	3.3	7.3	4.7	2.1
U.S.	4.7	8.0	4.7	2.5
Japan	-0.2	2.5	2.1	1.2
Euro Area	2.6	8.4	5.6	2.3
Germany	3.2	8.7	6.1	2.4
France	2.1	5.9	5.2	2.3
Italy	1.9	8.7	6.7	2.2
United Kingdom	2.6	9.1	6.1	2.2
Canada	3.4	6.8	3.7	2.3
Unemployment Rate (per cent annual averages)				
U.S.	5.4	3.6	3.6	4.5
Japan	2.8	2.6	2.4	2.4
Euro Area	7.7	6.7	7.1	7.7
Germany	5.7	5.3	5.7	5.9
France	7.8	7.3	7.5	7.9
Italy	9.5	8.1	8.5	9.0
United Kingdom	4.5	3.7	4.4	4.7
Canada	7.5	5.3	5.5	6.4

*Share of 2019 world gross domestic product (GDP) at PPP.

Forecast as at March 2023.

Source: National statistics agencies, TD Economics.

Global Economic Outlook				
Annual Per Cent Change Unless Otherwise Indicated				
	2019 Share*	Forecast		
Real GDP	(%)	2022	2023	2024
World	100.0	3.3	2.8	2.7
North America	19.2	2.3	1.3	1.0
United States	15.8	2.1	1.3	1.0
Canada	1.4	3.4	0.8	0.4
Mexico	1.9	3.1	1.3	1.6
European Union (EU-28)	15.4	3.6	0.7	0.8
Euro Area (EU-19)	12.5	3.5	0.6	0.5
Germany	3.5	1.9	-0.1	0.7
France	2.4	2.6	0.4	0.6
Italy	2.0	3.8	0.4	0.4
United Kingdom	2.4	4.0	-0.5	0.8
EU accession members	2.9	4.3	0.3	2.0
Asia	43.2	3.5	4.4	4.3
Japan	4.1	1.0	1.1	1.2
Asian NIC's	3.5	2.0	2.2	2.9
Hong Kong	0.3	-3.5	2.8	2.9
Korea	1.7	2.6	1.9	3.0
Singapore	0.4	3.6	2.1	2.7
Taiwan	0.9	2.5	2.6	2.9
Russia	3.1	-2.2	-0.6	1.8
Australia & New Zealand	1.2	3.5	2.0	2.0
Emerging Asia	31.4	4.6	5.7	5.2
ASEAN-5	5.7	5.9	5.0	5.1
China	17.3	3.0	5.7	4.6
India**	7.1	7.3	6.1	6.8
Central/South America	5.6	4.2	1.1	2.2
Brazil	2.4	3.0	1.0	2.0
Other Emerging Markets	13.0	3.2	3.4	3.1
Other Advanced	1.1	3.6	1.9	2.1

*Share of world GDP on a purchasing-power-parity (PPP) basis.

Forecast as at March 2023. **Forecast for India refers to fiscal year.

Source: IMF, TD Economics.