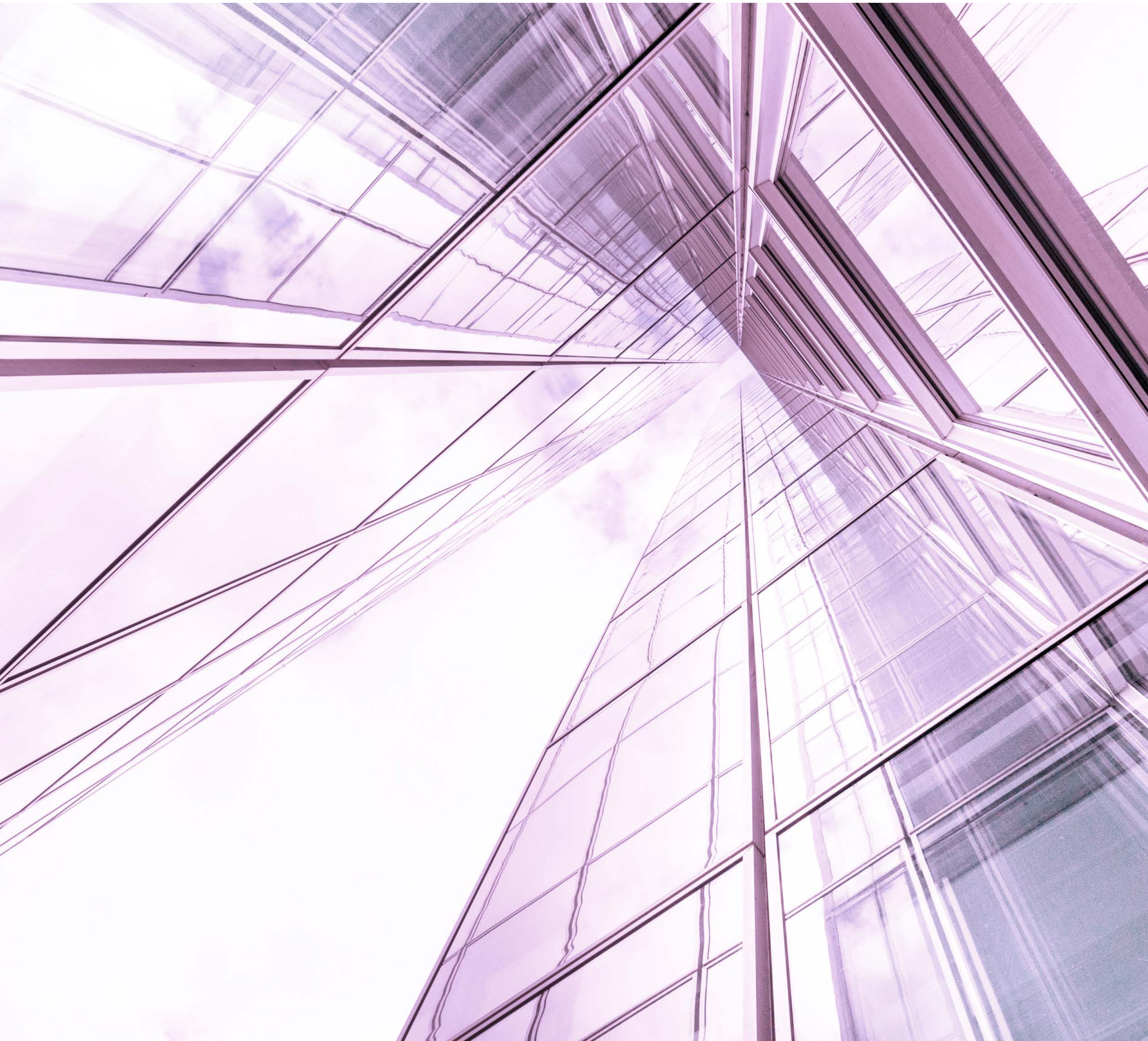
CIBC ASSET MANAGEMENT

PERSPECTIVES

Quarterly economic and market outlook

FALL | October 2023



> *Despite our continued call for a mild global recession, we are turning more constructive on select asset markets.*

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The times they are a-changin'

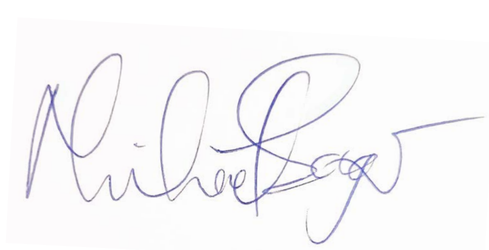
In the summer edition of Perspectives we asked whether investors should consider a global recession avoided or delayed. We noted our baseline scenario continued to call for a substantial weakening in cyclical economic conditions, consistent with a mild recession. But so far this year things have not been as painful as we expected.

So where are we now? In this edition of Perspectives, the CIBC Asset Management Multi-Asset and Currency team updates our 12-month outlook for growth and inflation as of September 30, 2023. There are no significant changes in our views on the broad direction of the global economy. A mild recession remains likely as the fight against inflation remains a priority across the Developed economies. Interest rates will likely stay higher for longer, as the goal of central banks remains to slow down economic activity.

We also discuss the investment implications of our economic views. Despite our continued call for a mild global recession, we are looking for opportunities in asset markets, and particularly high quality segments of the fixed income market. Across the range of plausible economic scenarios, including our base view, yields are likely close to their peak for this cycle. This gives us confidence investment-grade fixed income can provide investors with a positive return over the coming 12 months that exceeds cash interest rates.

We have embraced this opportunity in our Tactical Asset Allocation. We are also looking for unfolding opportunities in Canadian equities. Although recession risk threatens a further, shallow correction lower in the near term, this market's valuation has improved meaningfully, setting the stage for outperformance in the longer term.

We hope our insights help you navigate market volatility as you stay focused on your long-term investment goals. At CIBC Asset Management, we're committed to providing market and investment insights as well as best-in-class research. If you have any questions or would like to discuss our insights and commentary, please contact your advisor or CIBC representative any time.



Global asset class outlook

By Vincent Lépine, Francis Thivierge, Jean-Laurent Gagnon, Daniel Greenspan and Andrija Vesic

GLOBAL OVERVIEW: GRAND VICTORY OR GRAND ILLUSION WHEN IT COMES TO INFLATION?

For more than a year, central banks have been deploying their heavy policy arsenal to win the battle against inflation. Rate hikes and shrinking balance sheets have been on the menu. Lately, market expectations have increased confirming the long-awaited grand victory with inflation is within reach. If true, this would allow investors to breathe easier and also allow financial markets to continue climbing the wall of worry. So what will it be: a grand victory with inflation returning quickly to rates consistent with central bank policy targets or a grand illusion similar to the experience of the early 1970s?

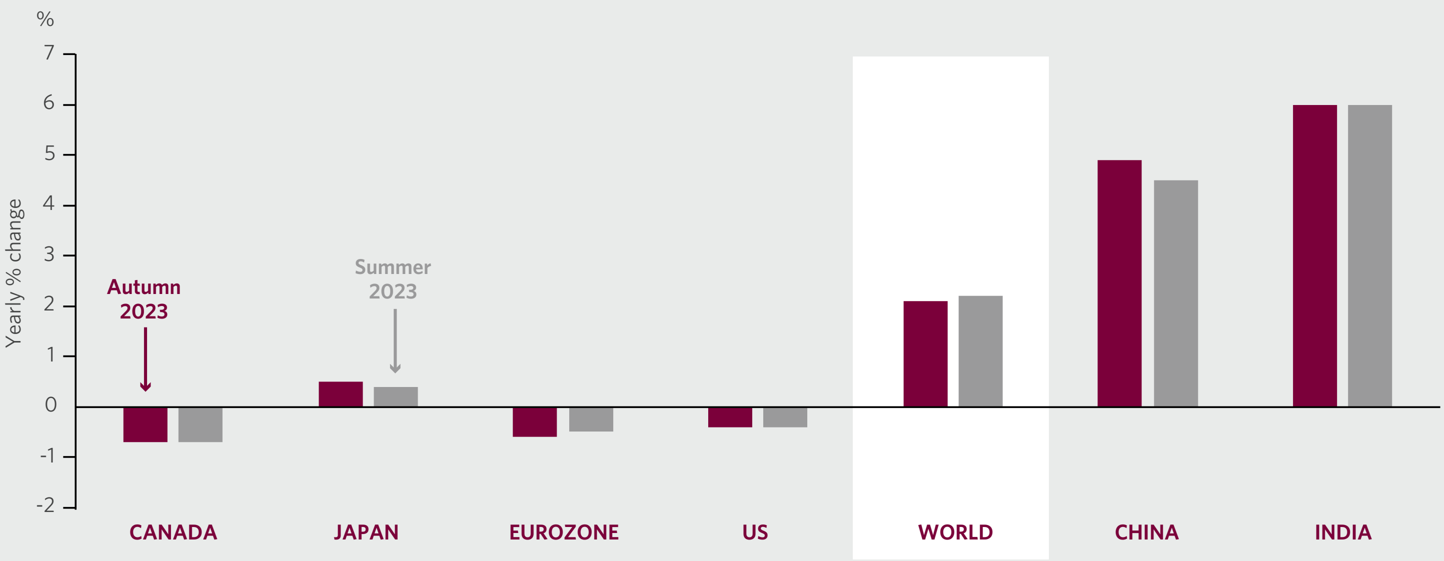
Currently, the dominant market view is that inflation will quickly decelerate back to the target rate of 2% over the next 12 months with no significant economic damage. This will pave the way for monetary policy to start easing in the second half of 2024. While it's true economic data, particularly in the US, has so far been consistent with a soft landing, it remains uncertain whether a continued gradual slowdown will be sufficient to adequately tame inflation. In fact, from a global perspective, the bulk of evidence points in the other direction.

Looking forward, we believe it will prove increasingly difficult for central banks to keep long-term inflation expectations anchored. Most importantly, labour market conditions remain tight in many countries with unemployment rates low and vacancy rates high. This tightness is a consequence of the demographic shock hitting the world economy.

It may be comforting to know that governments are addressing this problem by encouraging increased immigration. However, these efforts have so far proved to be inflationary by amplifying housing supply shortages.

Under these conditions, central banks will likely have to stay higher-for-longer than generally expected to completely wash out inflationary imbalances. Unfortunately, we believe this outcome will be accompanied by more damage to economic activity. While recognizing it has taken longer to unfold than we had originally expected, our baseline scenario still calls for a mild global recession.

GLOBAL GROWTH PROJECTIONS: SEPTEMBER VS. JUNE CAM FORECAST



Sources: Refinitiv-Datastream, Robert Shiller and CIBC Asset Management Inc. Based on data available as at September 29. 2023.

As we highlighted in the summer edition of Perspectives, it's important to recognize that central banks in the developed world are moving into the late stages of their tightening cycle. As the pressure on commercial banks intensifies, the risk of monetary policy overkill increases considerably. At this stage in the tightening cycle, bank lending rates tend to rise faster than policy rates. This means that a lot more money will have to be spent on interest payments, by all economic agents including households, non-financial corporations and governments. Higher debt service costs leave less money for discretionary spending.

Since the spring edition of Perspectives, we've had the view that monetary authorities would at times be forced to temporarily move away from a focus on dampening inflation and help provide support to distressed banks before switching back into inflation-fighting mode as soon as the situation is under control. This is what the US Federal Reserve (the Fed) did in the first half of 2023. Volatility in the financial sector at that time was short-lived and not too painful. Nonetheless, the relatively tranquil market conditions that have prevailed since then are unlikely to persist. The risk of further bouts of financial instability remains elevated.

MULTI-ASSET STRATEGY OUTLOOK: REASONS FOR OPTIMISM, IF INVESTORS STAY PATIENT AND FOCUSED ON THE LONG TERM

The terms 'recession' and 'soft landing' have different meanings to different people. Many observers associate recessions with a dark economic outlook. Certainly, the two recessions experienced in the past 20 years—the Covid-19 recession of 2020 and the Great Financial Crisis of 2008—were particularly difficult. By contrast, the term 'soft landing' often conjures images of a young girl with golden curly hair and three friendly bears. Our expectation for a mild recession lies somewhere in between these two extremes: not too bad, yet also not so good. We assign a probability of 55% to this outcome. It implies equity markets face the risk of a further correction lower in the near term, but are likely rangebound for the next 12 months as a whole. And bond yields are likely close to their peak for the current cycle, paving the way for better returns in fixed income.

The technical definition of a recession is two or more consecutive quarters of negative real GDP growth. This leaves a lot of definitional wiggle room, depending on how much GDP contracts and how long it remains negative. The deepest, most persistent recessions have typically been triggered by some variant of financial crisis. We currently assign a 10% probability to an alternative scenario in which financial instability inspired by excessive policy tightening causes a longer and deeper recession, although not one as severe as 2008. The implications for equity markets (deeper correction) and bonds (a larger fall in yields) are commensurately greater than under our main scenario.

We do not think a Goldilocks-style soft landing is likely. It implies a quick return of inflation to rates consistent with central bank policy targets, creating the opportunity for early and substantial cuts in policy interest rates. Instead, our soft landing alternative scenario, to which we assign a probability of 35%, is less benign. Growth remains relatively resilient, despite the extent of tightening in financial conditions over recent years. But inflation stays stubbornly high for an extended period, as central banks struggle to tame sticky labour market inflation. In this scenario, the tightening cycle is likely over but rate cuts do not come anytime soon; cautious central banks tread carefully, concerned that an early start to policy easing would reignite inflation pressures. Better corporate earnings, encouraged by resilient growth and the end of policy tightening would, by themselves, provide support to equity markets. However, with money market interest rates still elevated, equities would likely struggle to move meaningfully higher. Bond yields would likely decline under this scenario, although the extent of any move lower would be relatively limited.

All is not gloomy. Despite tight monetary policy and labour markets, elevated cost-push inflation, and low asset class risk premiums, some market and economic imbalances have begun to normalize. Reasons for optimism are slowly emerging, if investors stay patient and focused on the long term. Most central banks are at, or close to, the end of tightening cycles. In some emerging countries, policy easing has begun, which is likely to benefit equity markets outside of China. The bond market has backed up substantially. The road from near-zero yields to today's levels encompassed one of the worst bear bond markets in history. But the long-term direction for yields is lower under all our economic scenarios. Fixed income investment opportunities have become more attractive.

MULTI-ASSET OUTLOOK

Asset class	Current September 29, 2023	Most likely minimum of range for next 12 months	Most likely maximum of range for next 12 months
Canada 3-month T-Bills rate	5.00%	4.50%	5.50%
Canada 2-year government bond yield	4.87%	4.25%	5.25%
Canada 10-year government bond yield	4.02%	3.25%	4.25%
U.S. 10-year government bond yield	4.57%	3.50%	4.75%
Germany 10-year government bond yield	2.84%	1.75%	3.25%
Japan 10-year government bond yield	0.76%	0.50%	1.40%
Canada 10-year real-return government bond yield	2.27%	1.30%	2.50%
Canada investment-grade corporate spreads	1.43%	1.35%	1.90%
U.S. high-yield corporate spreads	3.97%	3.75%	4.25%
Emerging market sovereign (USD denominated) bond spreads	362	250	500
S&P/TSX price index	19,541	17,000	21,500
S&P 500 price index	4,288	3,600	4,700
Euro Stoxx 50 price index	4,175	3,500	4,600
Japan Topix price index	2,323	2,000	2,550
MSCI Emerging Markets index	58,515	50,000	65,000
U.S. dollar/Canadian dollar	1.3577	1.333	1.408
Euro/U.S. dollar	1.0573	1.00	1.120
U.S. dollar/Japanese yen	149.37	130.00	155.00
U.S. dollar/Offshore Chinese yuan	7.29	6.80	7.45
Gold	1,849	1,800	2,100
Oil price, WTI (West Texas Intermediate)	90.79	60.00	92.00

Source: Refinitiv Datastream, CIBC Asset Management Inc. Based on data available as at September 29, 2023.
All prices in home currency unless otherwise specified.

GLOBAL EQUITY MARKETS: EXPECTED TO TRADE IN WIDE RANGES

The strong performance of many equity markets in the first half of this year led numerous strategists to upgrade their outlook for the next 12 months. The continued rise in bond yields in Q3, despite resilient US economic activity, tempered this optimism, and the positive performance achieved earlier in 2023 has begun to unravel more recently.

As of September 29, 2023, the S&P/TSX Composite was up only 3.4% year to date (YTD). It has been broadly flat, and volatile, over the past two years. Indexes more exposed to the IT sector have fared better—the Nasdaq returned 34.4% during the first three quarters of 2023 and the S&P 500 13.1%—emphasizing the narrowness of this year's performance. But even these tech-heavier indexes recently gave back some of their performance from earlier this year, in response to higher bond yields.

We have remained less constructive on the near-term outlook for equity markets. This reflects our continued expectation for a mild global recession, as well as continued unattractive valuations, including versus cash, and particularly on a risk-adjusted basis. Growth in Europe and China has actually been somewhat weaker in the past several months than we expected. The US economy has remained more resilient — although leading indicators continue to suggest an underlying weakening. Recession still delayed, but also still not avoided.

We expect US equity indexes to remain in a wide trading range during the next 12 months, with some further downside risk if the economy does succumb to a mild recession. The expected risk-reward of US equities will likely remain challenging compared to either cash or fixed income investments. Importantly, our assessment would not change significantly if the US economy continues to avoid a mild recession and instead achieves a soft landing. In this case, inflation will likely remain above the Fed's target rate of 2%—and could even reaccelerate. The policy interest rate would stay higher for even longer than currently expected. And the equity risk premium—defined as the earnings yield, calculated as the inverse of the P/E ratio, minus cash—would remain unattractive.

The performance of European equity indexes was surprisingly strong in the second half of 2022, but the region has since shifted into a more challenging economic situation. And a challenging economic outlook and continued geo-political tensions with the US make the Chinese equity market unappealing for the foreseeable future.

Other regions of the global equity market appear more relatively attractive. Canada's valuation is more constructive than the US, including as a result of its deeper correction in recent months. But Canada is also a cyclical market dependent on the US economy. This tempers optimism in the near-term, but at least sets the stage for outperformance in the longer term.

Several emerging markets (EM) outside of China already appear relatively attractive. They screen as relatively inexpensive against longer-term valuation metrics, and either have better short-term growth prospects (some markets in Asia) or central banks that have begun, or are soon to embark upon, significant policy easing (Latin America).

With increasing cyclical differentiation between economies across the world, opportunities for value-adding tactical equity positioning are likely to increase in coming months.

GLOBAL FIXED INCOME MARKETS: IMPROVED OUTLOOK FOR RETURNS

Although global bond market performance was negative in the third quarter, under all our economic scenarios we think bond yields in most countries are likely close to their peaks for this cycle. This gives us confidence bonds can provide investors with positive returns over the coming 12 months.

Our core scenario of a mild global recession over the next 12 months suggests the 10-year US Treasury yield will likely ease back a little from current levels (4.57% on September 29, 2023), to approximately 4.00% during this period. This expectation also embeds our view that the supply of Treasuries will remain elevated due to continued high fiscal deficits in a period when some of the biggest buyers—including central and commercial banks, and sovereign wealth funds—are easing back on purchases. It is also consistent with our view that inflation will continue to moderate in the next 12 months, but will remain well above central bank targets.

In our main alternative scenario, activity in the global economy, and particularly the US, will remain relatively resilient despite numerous headwinds. In this soft landing outcome—characterized also by stubbornly high inflation—the 10-year Treasury yield will likely stay close to its current level during the next 12 months, with the Fed keeping its policy interest rate higher for even longer then currently priced and inflation at risk of a renewed move higher.

For completeness, there is a small risk of a more malignant turn in the economic outlook. In this case, the recent move up in bond yields, as well as relatively tight financial conditions more broadly, could lead to a more abrupt and deeper slowing in economic activity than expected. This slowdown would also likely be accompanied by an elevated risk of further financial instability, similar to the US banking sector issues earlier in 2023.

With inflation in this outcome also likely to decline more quickly than otherwise expected, this scenario likely trigger earlier policy easing than priced and a substantial drop in US Treasury yields. In this case, we see the US 10-year Treasury yield declining to approximately 3.50%. Supply issues mentioned above would likely prevent yields from falling further.

We expect the 10-year US Treasury yield to trade in a range of 3.50% to 4.75% over the next 12 months, with an equilibrium around 4.00%. Decomposing the nominal yield into its component parts, our expected range implies inflation break evens and real yields will remain above 2.00% and 1.50% on a probability-weighted basis, respectively.

Emerging market local bonds

Our strategy remains unchanged relative to last quarter. Investors should remain prudent and selective. Periods of global recession, even if mild, often lead to temporary EM bond outflows. Consequently, we remain tactically defensive in terms of EM local bond exposure. For EM USD debt, valuations are unappealing. Our exposure is low as we await for better entry points.

CURRENCIES

USD: Near-term strength, longer-term weakness
The US trade-weighted dollar index rose in the third quarter back to the top of its range established thus far this year. For coming quarters, the US dollar (USD) will likely remain supported by relatively attractive short-term interest rate differentials, consistent with the Fed's "higher-for-longer" policy path, which in turn reflects resilient economic activity and stubbornly high inflation.

Rising bond yields have also been positive for USD. In addition to resilient growth and inflation, yields have moved higher due to increased bond issuance to fund the large fiscal deficit in the context of the Fed reducing the size of its balance sheet as well as key foreign buyers, including central and commercial banks and sovereign wealth funds, paring back Treasury holdings. The US Treasury expects to borrow US$2 trillion by year-end. The risk of crowding out other borrowers, and a liquidity squeeze on financial markets is non-negligible. This also suggests a move higher in foreign exchange volatility, from current low levels.

Canadian Dollar: Rangebound
The Canadian dollar (CAD) rebounded in the third quarter, reflecting the rise in oil prices and the BoC's increasingly hawkish rhetoric. It ended September at $0.7365 versus the USD. As in the US, BoC policy hawkishness reflects continued elevated inflation and a more resilient economic environment than expected. We believe the BoC will find it challenging to reach it's inflation target rate of 2% in a timely manner given the current weakness of productivity and strong immigration — which are keeping core inflation high.

Oil is a two-edged risk for the CAD. If our forecast of a mild global recession materializes more quickly than expected, oil prices will likely recede from current levels. If this happens, it will remove a key support to the CAD. Taking all factors into account, we expect the CAD to trade between $0.71 and $0.75 against the USD over the next 12 months.

Euro: Vulnerable to further
The Euro (EUR) lost ground during the third quarter on the back of a stronger USD and a weakening domestic economy. It ended the period trading at $1.0573 as of September 29, 2023.

Eurozone survey data highlight the risk of a deeper contraction in economic activity in coming months, consistent with the observed tightening of bank lending standards and depressed growth in credit conditions.

As a result, in September the ECB delivered what will likely be its last interest rate increase in the current tightening cycle. Its dovish hike contrasted with the Fed's hawkish hold announced in the same week. This likely means monetary policy will not support the EUR, unlike earlier in 2023. As a result, we expect the EUR to trade between 1.00 and 1.12 against the USD over the next 12 months.

Japanese Yen: Increasingly cheap
The Japanese Yen (JPY) ended the third quarter trading at ¥149.37 against the USD. According to our estimates, it is the cheapest currency in the G10 universe. However, it remains an attractive funding currency due to low domestic interest rates. That said, the need for monetary policy re-normalization by the Bank of Japan (BoJ) is becoming more pressing due to inflation in Japan broadening and becoming more firmly embedded.

The adjustment announced by the BoJ to its yield curve control (YCC) policy in July was only a technical change. However, as consumer price inflation is set to remain well above the BoJ's 2% target rate, we think its likely YCC will soon be abandoned. We also think the BoJ's Negative Interest Rate Policy (NIRP) might also be replaced in the next 12 months by a slightly positive policy rate. This latter change would be a significant shift in policy stance, and would likely be very positive for JPY.

Given our policy expectations, we expect Japanese government bond yields to continue de-anchoring in the next 12 months, suggesting interest rate differentials between Japan and the G10 will likely narrow. The USD/JPY exchange rate is projected to appreciate over the next 12 months and trade between ¥130 and ¥155.

COMMODITIES: GEOPOLITICS UPSET MARKETS

Oil
Crude oil has traded in a fairly tight range of $70 USD-$80 USD per barrel (bbl) for much of this year. It had brief periods of fluctuation above and below this range earlier the year as investors weighed a disciplined supply against a more uncertain outlook for demand. Recently, oil moved above this range as inventory levels have lowered, OPEC+ (Russia and Saudi Arabia) extended output cuts to the end of the year and war broke out in the Middle East. Crude oil is currently trading at $90.79/bbl, as of September 29, 2023.

Our outlook for oil is challenging as fears of a wider conflict in the Middle East are difficult to predict and could have a material price impact. We expect oil supply to remain disciplined with limited growth from North American producers and a continued willingness to keep barrels out of the market from key members of OPEC+. On the demand side, data remains healthy as well, with Chinese demand still strong, somewhat offset by investor fears of recession in other key end markets such as Europe and the US.

Until there is clarity on a resolution to the war in the Middle East, the price of oil will likely continue to be elevated as it prices in some risk premium. As we're expecting a mild economic recession, the oil price could move meaningfully lower from current levels.

Gold
The price of gold drifted lower over the summer and into the fall as the USD strengthened throughout August and September on hawkish Fed policy rate expectations. In recent years, the price of gold has been closely tied inversely to the USD. Gold is currently trading at $1,849 USD per troy ounce, as of September 29, 2023.

The war in the Middle East reminds us that gold continues to have a role to play as a hedge against geopolitical risks. It changed the narrative for gold as investors bid up the metal's price as a safe haven asset during a time of geopolitical uncertainty.

As with oil, our outlook for gold is challenging. Fears of a wider conflict in the Middle East could lend further support to gold. If there is a near-term resolution to the war, we expect some of the risk premium currently built into the price of gold to come out. We see gold trading in a range of $1,800-$2,100 per troy ounce over the next 12 months.

Global and regional economic views

By Vincent Lépine, Eric Morin, and Andrija Vesic

THE UNITED STATES: SOFT LANDING MISSION ACCOMPLISHED?

Moving into the second half of the year, many market participants joined the soft landing bandwagon, becoming a lot more upbeat about prospects for the US economy. This is not surprising as the US economy has proven unexpectedly resilient. This resilience can be explained by an unusual combination of factors that have supported economic activity.

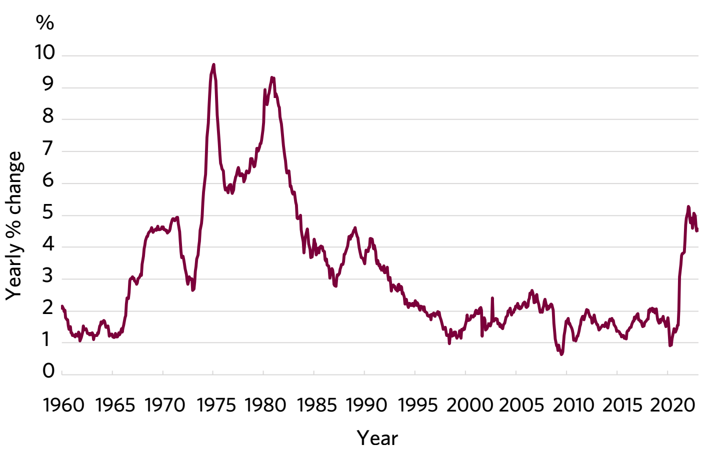
One factor relates to the depletion of excess savings accumulated by US households during the Covid-19 pandemic in support of consumption spending. These savings cushioned the negative impact on spending during a period of high inflation and fast-rising interest rates.

Another factor has been the unexpected big fiscal stimulus delivered by the US Federal Government in the first half of 2023. This stimulus had three elements:

- Strong government incentives that triggered a boom in factory construction
- Social Security and Supplemental Security Income benefits that were raised by more than 8% at the start of the year, the biggest yearly inflation indexation adjustment since the early 1980s
- A freeze on student loan repayments

There has been a third, less discussed, factor at work, too. It relates to the exceptionally large support provided to the US banking sector. On top of the Fed's emergency liquidity injection in March 2023, there has been a substantial increase in lending from Government Sponsored Enterprises (GSEs; namely Freddie Mac and Fannie Mae) to Federal Home Loan Banks (FHLBs). This is important because it enabled US commercial banks to avoid shrinking loan books in the context of a deep contraction in deposits. In this way, the FHLBs have acted as a proxy lender of last resort to the US banking sector alongside the Fed. Without this support, bank lending would have contracted and economic activity would have proven much less resilient.

US core PCE inflation - yearly % change



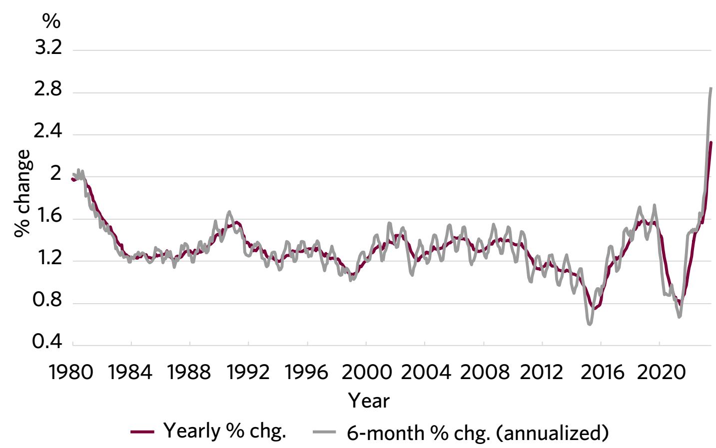
Source: LSEG Datastream. Based on data available as at September 29, 2023.
"PCE"= Personal Consumption Expenditures.

Currently, the relevant question is whether these three factors will remain supportive to economic activity in coming quarters, allowing for a continued soft landing of the US economy. We don't think so because the cushion of excess savings is largely exhausted at a time when household debt servicing payments are set to rise sharply. Just as important, the fiscal impulse to growth experienced earlier this year is expected to turn into a large fiscal drag. And a tightening in commercial bank lending conditions will likely begin to amplify the impact of the Fed's tightening cycle. Resilience will likely turn into a recession.

CANADA: OUR POPULATION SURGE IS COMPLICATED

For years, economists warned that aging demographics would act as a drag on economic growth. To offset the impact of the demographic shock, an increase in skilled-based immigration offered a solution. With Canada's population now growing at its fastest pace on record, the government has clearly delivered; the country's population has increased by 749,000 over the last 12 months compared to 467,000 in 2022 and 254,000 in 2021. The question now is whether this sudden swing in population has proceeded too fast.

Record Canadian population growth



Source: LSEG Datastream. Based on data available as at September 29, 2023.

The Fed's battle on high inflation is not over

Canada's immigration plan was intended to solve workforce shortages. But so far, there's no evidence it's working. The population surge has led to only a modest narrowing of the unemployment gap. And although the job vacancy rate is trending lower, it remains too high. Based on these yardsticks, Canada's labour market is still tight. This explains why wage growth has remained stubbornly elevated over the last year, and actually reaccelerated in July 2023 to 5.2%.

The problem for the Bank of Canada (BoC) isn't only that wage growth is too strong and labour market conditions are too tight. It is also that labour productivity is contracting, falling 2.2% below pre-pandemic levels in 2019 Q4. As a result, Unit Labour Cost (ULC) inflation remains far above the BoC's comfort zone. To successfully get core CPI inflation back to its 2% target rate, wage growth has to decelerate closer to 3%, under the assumption that productivity growth returns to its trend of 1%.

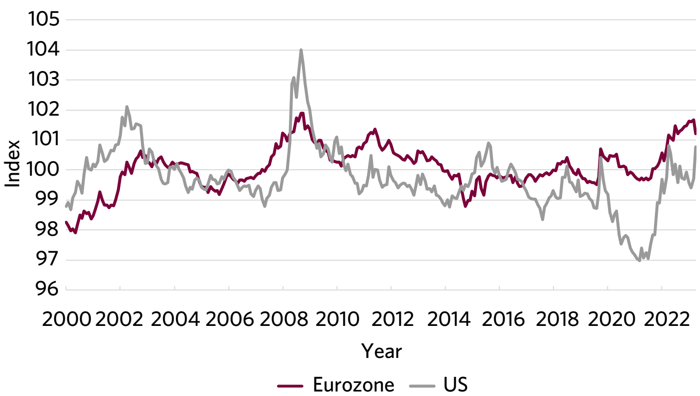
The fact that population growth has increased so rapidly is further complicating the BoC's task on inflation. The Canadian rental vacancy rate declined sharply in 2022, to below 2.0% at year-end. This decline coincided with a sharp rise in year-on-year rent inflation, which climbed to 6.3% in August 2023– its highest reading since the stagflation episodes of the mid 1970s and early 1980s.

The surge in population makes winning the battle against inflation more difficult for the BoC than projected by the consensus. The BoC's inflation target for core inflation rate of 2% is likely out of reach in the next 12 months, keeping its policy stance in "higher-for-longer" mode over the forecast horizon.

EUROZONE: SINKING DEEPER INTO STAGFLATION

In sharp contrast to the US and Canada, Eurozone economic activity has proven less resilient over the first half of the year, and the region has experienced a shallow German-led recession. The growth differential between Europe and the US so far in 2023 can be explained by a particularly severe tightening in Eurozone financial conditions, comparable to the pronounced recession of 2007-2008.

A severe tightening in Eurozone financial conditions



Source: Bloomberg, Goldman Sachs. Based on data available as at September 29, 2023.

The question now is whether the Eurozone economic downturn will ultimately become a disinflationary or a stagflationary bust? This nuance is important. Over the last four decades, all economic downturns have been disinflationary. By contrast, in the mid-1970s and early 1980s efforts to control high inflation proved much more damaging to economic growth. In our opinion, the Eurozone risks sinking deeper into a similar period of stagflation.

The first place to look for evidence of disinflation is Germany. Already in a recession, Germany's unemployment rate has been trending higher. Unfortunately, with an elevated job vacancy rate, it's clear German labour market conditions have not yet sufficiently loosened to bring inflation back to a rate consistent with the European Central Bank's (ECB) 2% policy target. And Similar to Canada, a population surge intended to solve workforce shortages is complicating matters for the ECB by accentuating housing imbalances.

As a result, and despite its concerted efforts, the ECB has not made significant progress in returning inflation back to target. Core and headline inflation rates are actually well above the levels it projected a year ago. Annual wage inflation has reaccelerated to 5.5%. Also similar to Canada, Eurozone labour productivity has been declining. The Eurozone is sinking deeper into stagflation. And as with other developed market central banks, the ECB will likely have to continue with a restrictive policy stance for longer than currently expected by the consensus.

CHINA: TECTONIC PLATES ARE MOVING

We remain relatively pessimistic on Chinese cyclical economic prospects. After a weak post-zero Covid-19 bounce, Chinese growth has remained lackluster. There will likely be some improvement in coming months in response to a collection of incremental policy initiatives announced in recent weeks. But the extent of the recovery is expected to be tepid. China will likely remain in a growth recession.

The country has also entered into a new growth regime. We believe the period of excessive reliance on housing and infrastructure investment as major economic engines is over. Both sectors contributed more than a third of Chinese growth over the past decade, fueled by stimulative policies. With the emergence of excess supply and balance sheet problems, the traditional stimulus playbook is no longer a solution. Both sectors will likely subtract from aggregate Chinese growth over the next few years.

US efforts to reduce its perceived excessive reliance on products made in China represents another headwind to prospective growth. More broadly, foreign investment in China has fallen as investors and manufacturers become increasingly concerned about political risks. These risks could increase further. Cells of the Chinese Communist Party have gained influence in the strategic decision making of private companies. This could facilitate implementation of a Military-Civil Fusion strategy, where the private sector becomes a key stakeholder in building future military systems.

In this context, Chinese growth is expected to remain weak, albeit with contained downside risks. Our central forecast sees average growth of 4.5% for the next four quarters, well below rates realized in the past few decades. And inflation will likely remain weak throughout this period. We do not expect a significant policy stimulus. Instead, we see only modest interest rate cuts by the People's Bank of China with some additional liquidity provision designed to shore up the economy, particularly in the face of our expected mild global recession. The scope to implement more substantive policy stimulus—for instance, focused on the transformation of underdeveloped regions into mega-cities—appears limited for fear of stoking deeper secular vulnerabilities.

Economic forecasts (next 12 months)

Region	Current GDP[1]	GDP - consensus	GDP - CAM view	Current inflation[2]	Inflation - consensus	Inflation - CAM view	Policy rate - CAM view
Canada	1.1%	1.0%	-0.8%	4.0%	2.8%	3.4%	+50 bps
United States	2.4%	1.2%	-0.4%	3.7%	2.9%	3.2%	+50 bps
Eurozone	0.5%	0.5%	-0.6%	4.3%	3.0%	3.2%	+50 bps
China	6.3%	4.5%	4.5%	0.1%	1.3%	1.0%	-
Japan	1.6%	1.2%	0.4%	3.1%	2.2%	3.0%	-
World	2.5%	2.5%	2.2%	4.3%	3.9%	5.1%	-

Source: CIBC Asset Management Inc. Based on data available as at September 29, 2023.

1 Real GDP growth (y/y %)
2 Year/year %

Alternative scenarios

By Vincent Lépine and Francis Thivierge

GLOBAL SOFT LANDING: PROBABILITY 35% (PREVIOUSLY 30%)

Although our main scenario still calls for a mild global recession, there's a path through a period of slower growth that actually avoids a recession altogether.

Realizing a soft landing requires a policy-induced growth slowdown that generates just enough slack in the economy to return inflation back to it's target rate of 2%. Also, supply chain disruptions that initially sparked inflation would no longer be at play.

A successful soft landing would pave the way for a relatively better outlook for risky assets. But even under this scenario, market upside would be limited by current elevated valuations relative to cash. Inverted bond yield curves may normalize in a bear steepener, as longer-dated yields could rise a little further from current levels and short-dated yields would likely stay higher for longer.

Delivering this outcome will prove to be a delicate balancing act. Goods inflation has spilled over to labour markets, and wage inflation tends to be relatively persistent. The fact that growth is currently slowing without inflicting much damage on labour market conditions means cost-push inflation pressures may actually reaccelerate in a soft landing. Central banks would need to remain vigilant to this risk.

FINANCIAL INSTABILITY: PROBABILITY 10% (UNCHANGED)

Under this scenario, the speed and amount of monetary tightening that has already taken place turns out to be too much for the banking sector and wider economy to cope with, leading to bouts of financial instability.

Stuck with a more severe hit on profitability, as well as deteriorating liquidity conditions, banks would have no choice but to substantially tighten lending standards. The combined impact of the sharp rise in policy rates and a more aggressive tightening in bank lending conditions would become too big of a shock, knocking the global economy down.

As a result, the recession would turn out to be deeper and longer than expected in our baseline projection. More severe demand destruction is accompanied by a relatively rapid deceleration in inflation. Under such conditions, central banks shift into easing mode a lot faster than expected in order to restore financial stability.

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About CIBC Asset Management

At CIBC Asset Management, we believe that every customized investment solution begins with research and rigour. We specialize in a variety of investment solutions such as equities, fixed income, currency management, liability-driven investments, asset allocation, and responsible investments.

Across a spectrum of investment solutions, we commit to best-in-class research. Dedicated sector and regional analysts focus on industry research and security-specific idea generation. Our investment professionals leverage deep and diverse expertise by sharing proprietary research across asset-class teams. By sharing insight across asset class teams, we maximize opportunities to add value to our client portfolios.

Contact us any time

To learn more about CIBC Asset Management and our investment solutions, please contact your advisor or your CIBC representative. For more insights, connect with us on LinkedIn and Twitter.

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