ECONOMIC NEWS

#1 BEST OVERALL FORECASTER - CANADA

Turbulence on the Markets: Not Enough to Destabilize the Economy!

The markets have been on a definite downswing since the beginning of October. That echoes of the beginning of the year, when we saw rollbacks of around 10%. Should we be worried about how all that turbulence will affect the economy's future? We need to set some things straight.

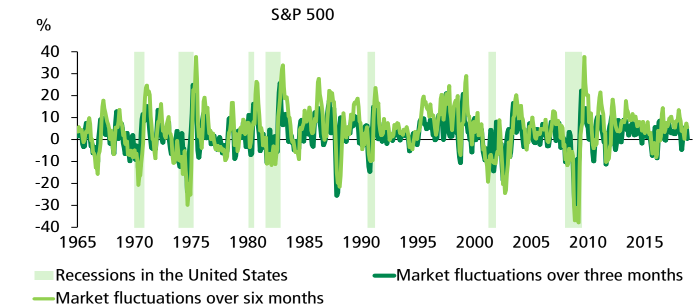
Among other things, the corrections of the past few days seem to be a reaction to interest rate hikes. Some investors see that as a chance to review the asset allocations in their investment portfolios, to the detriment of company shares. Investors also seem to be anxious about the impact that the interest rate hikes will have on the economy and business profits. On that point, it should be made clear that the current increase in interest rates reflects sustained economic growth, which is creating more inflationary pressure. That makes increased interest rates desirable to avoid overheating of the economy and inflation problems.

However, other factors are also fanning investors' concerns. The European markets reacted badly to the new Italian government's decision to increase its public deficit. It revived fears as to the long-term sustainability of the Italian debt. Trade tensions between China and the United States are another issue. The risk of tariff escalations appears more plausible and could affect other countries. Business profits could ultimately go down.

Despite all those risks, it is too soon to bet on an economic slowdown or even a recession. It would take a lot more to halt the impetus, especially since the U.S. economy is still being stimulated by lower taxes and higher public spending.

If you are simply worried about the effect the markets could have on household confidence, and eventually on the economy as a whole, the graph below should provide some reassurance. The markets have often made significant corrections in the past without plunging us into recession. It usually takes about a 20% decline over three to six months for the risk to become more serious.

GRAPH
The markets often make corrections which do not automatically lead to recessions



Sources: Datastream, Bureau of Economic Analysis and Desjardins, Economic Studies

IMPLICATIONS

Even if market turbulence continues for a few more weeks, it is too soon to talk about economic difficulties. That said, these corrections are significant reminders that there are still risks to economic growth. That is a good reason for the central banks to remain cautious and go on raising interest rates gradually.

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