

Six Months after Shutdown

A Publication of BMO Capital Markets Economic Research • Douglas Porter, CFA, Chief Economist, BMO Financial Group

Today marks not just the 19-year anniversary of that tragic day in 2001, but also six months of the pandemic (according to the WHO). On the latter, it's appropriate to take stock of where we stand. Even with a further softening in tech this week, the bigger picture is that **markets have staged a remarkably rapid recovery** from the fearsome five-week plunge earlier in the year. The TSX, for one, managed to hold steady amid this week's choppiness—ah, September—and is now up nearly 45% from the March depths (almost precisely in line with the MSCI World index). And, we would respectfully submit that **the overall North American economic backdrop has also come back faster and stronger than widely expected**, at least compared to the conventional wisdom at the depths in the spring.

While this week was relatively light on the economic data front, the few key selected indicators on hand mostly fit into the bigger narrative of a firmer-than-anticipated recovery. In the U.S., **inflation is moving back to some kind of normal**, with CPI popping 0.4% on both headline and core in August, largely due to a snap-back in used vehicle prices. While 1.7% y/y underlying inflation won't scare anyone, it shows that deflation risks are fading fast. Meantime, the **JOLTS survey** revealed that layoffs fell back to below-normal levels in July, suggesting there is no big second wave coming in joblessness. The latest quarterly **Manpower survey** pointed to a surprisingly big pick-up in hiring plans for Q4; the +14% result is still down from +19% at the start of 2020, but it didn't get this high until we were five years into the prior recovery. Finally, the **NFIB** reported that small business hiring plans and sentiment rebounded last month; while the latter was still down 4% from pre-pandemic levels, it would still rank above almost any reading in the decade prior to 2016.

Forecasters are taking note of the steady run of high-side economic surprises. The latest Blue Chip survey, which was conducted late last week, reveals that the **consensus call on U.S. GDP growth has risen for three months in row**, after bottoming out in early June. The median forecast is now a drop of 4.6% this year (up a hefty 1.5 percentage points from the low of -6.1% three months ago), and a rebound of 3.8% in 2021. That consensus view has moved almost in line with our calls (we are a tad stronger on both years at -4.5% and +4.0%), and the range of estimates has narrowed notably. Dispensing with a few outliers at both extremes, the spread of forecasts around the average is now roughly +/-1 ppt in 2020 and +/-1.5 ppts next year.

Similarly, **forecasts are nudging up overseas**, with the emphasis on nudging. **China** looks to be one of the rare economies headed for outright growth this year, with GDP likely to be up at least 2%. August trade was a bit light of expectations, but still posted a 9.5% y/y gain in exports (in USD terms), as factories benefit from the robust global rebound in goods purchases. Unfortunately, that strength has not been mirrored in China's domestic demand, as imports were still down 2.1% y/y. As a result, the trade surplus has gapped wider again, to \$59 billion in the month and \$409 billion in the past

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year—a bit above the average of the prior three years. The persistence of the trade imbalance points to ongoing friction with the U.S. on this front, likely regardless of the outcome of the U.S. elections (less than 8 weeks away!).

Germany, too, is seeing a rebound in exports, a big reason GDP forecasts are being lifted there as well. As but one example, the DIW institute cranked up its view on 2020 to -6% from the previous dour call of -9.4%. We believe the result will be closer to -5%, although Germany is definitely at the positive end of the EU spectrum. And, the ECB this week lifted its view on the Euro Area economy to -8% for 2020 (from -8.7%), while looking for a 5% rebound next year—both still shy of our view. Given the recent upswing in virus cases in a number of key economies there, and some rollbacks in opening measures, we have trimmed our call slightly to -7% (from -6.7%) for this year, and +6.0% for 2021 (from +6.3%). Rollbacks were prominent this week for the **U.K.**, and we continue to look for roughly a 10% drop in GDP there this year. Note that given the monthly patterns, with activity hitting rock bottom in April, annualized GDP growth is on track for a gaudy rise in Q3 (of roughly 80%), yet Britain will still post one of the biggest declines this year due to a sharp first-half plunge.

The overwhelming factor behind the generally positive surprises for economic data has been the **tidal wave of government support**. Essentially, transfer payments have kept households whole, and in some cases more than making up for lost wages. That's been the case in the U.S. and Canada, where disposable incomes have actually accelerated this year, not cratered... as is typically the case in a downturn. And, frankly, it is the extent of government support that many forecasters underestimated at the depths of the downturn. Just as one example from Canada, the Q2 spike in income and savings helped carve deeply into closely-watched household debt/income ratios. Along with a slowing in debt growth, the smoothed ratio fell to just below 167%, down nearly 8 ppts from last year's record high. The flip side is that government gross debt/GDP fired up 18 ppts to above 132% (also skewed by the plunge in GDP that quarter).

Looking ahead, there are clearly at least **three sources of uncertainty/concern** for the broader outlook. **First**, there is the apparently complete impasse on another round of U.S. fiscal stimulus. As hard as it would have been to believe a few short weeks ago, it now seems entirely believable that we are headed into the election with no new measures. **Second**, the markets are increasingly focussing on said election, and its associated uncertainty with the race tightening in key battleground states. **Finally**, there is the ongoing concern about the rising number of new virus cases in many nations; in some instances, a rapid rise. On that note, we would offer the reassuring fact that U.S. new cases have quietly receded in recent weeks to nearly half the peaks of late July, and that the U.S. economy managed to soldier through its upswing in cases over the summer. True, even Canada has seen the pace of new cases almost double in the past week; but, in per capita terms, it's still running at less than 1/6th the U.S. pace. That's not to downplay the risks ahead, but just to keep them in perspective.

Perhaps the award for the “*Biggest Upside Surprise during the Pandemic*” may well go to **Canadian housing**. Robert Kavcic goes into much greater detail in this week’s Focus Feature, but some of the results have shocked even the least bearish forecasters (*ahem*). To pick just one data point, housing starts vaulted in August to above 262,000

units, one of their highest monthly tallies in the past 30 years. While no doubt some of this outsized strength simply makes up for lost activity in the spring, we now believe that starts will actually manage to nudge slightly higher for 2020 versus last year. As is the case for U.S. starts, this means home building will be one of the very rare areas that will post positive growth in an extremely challenging year for the broader economy.

The strength in building is simply following in the wake of the rapid recovery in home sales. We expect next week's August existing sales to post another rise of roughly 30% y/y, leaping to a record high in seasonally adjusted terms. Like starts, we believe that this surge will largely offset the spring shutdown, leaving year-to-date sales almost level. On the price front, cities that were hot before the pandemic—Montreal, Ottawa, Toronto, and pretty much all of Southwestern Ontario—have re-emerged even hotter than before. As a result, look for mortgage debt to begin re-accelerating. We suspect that policymakers will mostly grin and bear this renewed heat in housing, tacitly accepting growth where they can find it in these deeply challenging times.

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