

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

ECONOMIC RESEARCH
economics.bmo.com

Douglas Porter, CFA, Chief Economist
douglas.porter@bmo.com

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.

General Disclosures

"BMO Capital Markets" is a trade name used by the BMO Investment Banking Group, which includes the wholesale arm of Bank of Montreal and its subsidiaries BMO Nesbitt Burns Inc., BMO Capital Markets Limited in the U.K., Bank of Montreal Europe Plc in Ireland and BMO Capital Markets Corp. in the U.S. BMO Nesbitt Burns Inc., BMO Capital Markets Limited, Bank of Montreal Europe Plc and BMO Capital Markets Corp are affiliates. BMO does not represent that this document may be lawfully distributed, or that any financial products may be lawfully offered or dealt with, in compliance with any regulatory requirements in other jurisdictions, or pursuant to an exemption available thereunder. This document is directed only at entities or persons in jurisdictions or countries where access to and use of the information is not contrary to local laws or regulations. Their contents have not been reviewed by any regulatory authority. Bank of Montreal or its subsidiaries ("BMO Financial Group") has lending arrangements with, or provide other remunerated services to, many issuers covered by BMO Capital Markets. The opinions, estimates and projections contained in this report are those of BMO Capital Markets as of the date of this report and are subject to change without notice. BMO Capital Markets endeavours to ensure that the contents have been compiled or derived from sources that we believe are reliable and contain information and opinions that are accurate and complete. However, BMO Capital Markets makes no representation or warranty, express or implied, in respect thereof, takes no responsibility for any errors and omissions contained herein and accepts no liability whatsoever for any loss arising from any use of, or reliance on, this report or its contents. Information may be available to BMO Capital Markets or its affiliates that is not reflected in this report. The information in this report is not intended to be used as the primary basis of investment decisions, and because of individual client objectives, should not be construed as advice designed to meet the particular investment needs of any investor. This document is not to be construed as an offer to sell, a solicitation for or an offer to buy, any products or services referenced herein (including, without limitation, any commodities, securities or other financial instruments), nor shall such information be considered as investment advice or as a recommendation to enter into any transaction. Each investor should consider obtaining independent advice before making any financial decisions. This document is provided for general information only and does not take into account any investor's particular needs, financial status or investment objectives. BMO Capital Markets or its affiliates will buy from or sell to customers the securities of issuers mentioned in this report on a principal basis. BMO Capital Markets or its affiliates, officers, directors or employees have a long or short position in many of the securities discussed herein, related securities or in options, futures or other derivative instruments based thereon. The reader should assume that BMO Capital Markets or its affiliates may have a conflict of interest and should not rely solely on this report in evaluating whether or not to buy or sell securities of issuers discussed herein.

Dissemination of Economic Publications

Our publications are disseminated via email and may also be available via our web site <https://economics.bmo.com>. Please contact your BMO Financial Group Representative for more information.

Additional Matters

This report is directed only at entities or persons in jurisdictions or countries where access to and use of the information is not contrary to local laws or regulations. Its contents have not been reviewed by any regulatory authority. BMO Capital Markets does not represent that this report may be lawfully distributed or that any financial products may be lawfully offered or dealt with, in compliance with regulatory requirements in other jurisdictions, or pursuant to an exemption available thereunder.

To Australian residents: BMO Capital Markets Limited is exempt from the requirement to hold an Australian financial services licence under the Corporations Act and is regulated by the UK Financial Conduct Authority under UK laws, which differ from Australian laws. This document is only intended for wholesale clients (as defined in the Corporations Act 2001) and Eligible Counterparties or Professional Clients (as defined in Annex II to MiFID II).

To Canadian Residents: BMO Nesbitt Burns Inc. furnishes this report to Canadian residents and accepts responsibility for the contents herein subject to the terms set out above. Any Canadian person wishing to effect transactions in any of the securities included in this report should do so through BMO Nesbitt Burns Inc.

To U.K./E.U. Residents: In the UK, Bank of Montreal London Branch is authorised and regulated by the Prudential Regulation Authority and the Financial Conduct Authority ("FCA") and BMO Capital Markets Limited is authorised and regulated by the FCA. The contents hereof are intended solely for the use of, and may only be issued or passed on to, (i) persons who have professional experience in matters relating to investments falling within Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (the "Order") or (ii) high net worth entities falling within Article 49(2)(a) to (d) of the Order (all such persons together referred to as "relevant persons"). The contents hereof are not intended for the use of and may not be issued or passed on to retail clients. In an E.U. Member State this document is issued and distributed by Bank of Montreal Europe plc which is authorised and regulated in Ireland and operates in the E.U. on a passported basis. This document is only intended for Eligible Counterparties or Professional Clients, as defined in Annex II to "Markets in Financial Instruments Directive" 2014/65/EU ("MiFID II").

To Hong Kong Residents: This document is issued and distributed in Hong Kong by Bank of Montreal ("BMO"). BMO is an authorized institution under the Banking Ordinance (Chapter 155 of the Laws of Hong Kong) and a registered institution with the Securities and Futures Commission (CE No. AAK809) under the Securities and Futures Ordinance (Chapter 571 of the Laws of Hong Kong). This material has not been reviewed or approved by any regulatory authority in Hong Kong. Accordingly the material must not be issued, circulated or distributed in Hong Kong other than (1) except for "structured products" as defined in the Securities and Futures Ordinance, in circumstances which do not constitute it as a "Prospectus" as defined in the Companies Ordinance or which do not constitute an offer to the public within the meaning of that Ordinance, or (2) to Professional investors as defined in the Securities and Futures Ordinance and the Securities and Futures (Professional Investor) Rules made thereunder. Unless permitted by the securities laws of Hong Kong, no person may issue in Hong Kong, or have in its possession for issue in Hong Kong this material or any other advertisement, invitation or document relating to the products other than to a professional investor as defined in the Securities and Futures Ordinance and the Securities and Futures (Professional Investor) Rules.

To Korean Residents: This material is not provided to make a recommendation for specific Korean residents to enter into a contract for trading financial investment instruments, for investment advising, for discretionary investment, or for a trust, nor does it constitute advertisement of any financial business or financial investment instruments towards Korean residents. The material is not provided as advice on the value of financial investment instruments or any investment decision for specific Korean residents. The provision of the material does not constitute engaging in the foreign exchange business or foreign exchange brokerage business regulated under the Foreign Exchange Transactions Act of Korea.

To PRC Residents: This material does not constitute an offer to sell or the solicitation of an offer to buy any financial products in the People's Republic of China (excluding Hong Kong, Macau and Taiwan, the "PRC"). BMO and its affiliates do not represent that this material may be lawfully distributed, or that any financial products may be lawfully offered, in compliance with any applicable registration or other requirements in the PRC, or pursuant to an exemption available thereunder, or assume any responsibility for facilitating any such distribution or offering. This material may not be distributed or published in the PRC, except under circumstances that will result in compliance with any applicable laws and regulations.

Singapore Residents: This document has not been registered as a prospectus with the Monetary Authority of Singapore and the material does not constitute an offer or sale, solicitation or invitation for subscription or purchase of any shares or financial products in Singapore. Accordingly, BMO and its affiliates do not represent that this document and any other materials produced in connection therewith may lawfully be circulated or distributed, whether directly or indirectly, to persons in Singapore. This document and the material do not and are not intended to constitute the provision of financial advisory services, whether directly or indirectly, to persons in Singapore. This document and any information contained in this report shall not be disclosed to any other person. If you are not an accredited investor, please disregard this report. BMO Singapore Branch does not accept legal responsibility for the contents of the report. In Asia, Bank of Montreal is licensed to conduct banking and financial services in Hong Kong and Singapore. Certain products and services referred to in this document are designed specifically for certain categories of investors in a number of different countries and regions. Such products and services would only be offered to these investors in those countries and regions in accordance with applicable laws and regulations. The information is directed only at persons in jurisdictions where access to and use of such information is lawful.

To Thai Residents: The contents hereof are intended solely for the use of persons qualified as Institutional Investors according to Notification of the Securities and Exchange Commission No. GoKor. 11/2547 Re: Characteristics of Advice which are not deemed as Conducting Derivatives Advisory Services dated 23 January 2004 (as amended). BMO and its affiliates do not represent that the material may be lawfully distributed, or that any financial products may be lawfully offered, in compliance with any regulatory requirements in Thailand, or pursuant to an exemption available under any applicable laws and regulations.

To U.S. Residents: BMO Capital Markets Corp. furnishes this report to U.S. residents and accepts responsibility for the contents herein, except to the extent that it refers to securities of Bank of Montreal.

These documents are provided to you on the express understanding that they must be held in complete confidence and not republished, retransmitted, distributed, disclosed, or otherwise made available, in whole or in part, directly or indirectly, in hard or soft copy, through any means, to any person, except with the prior written consent of BMO Capital Markets.

ADDITIONAL INFORMATION IS AVAILABLE UPON REQUEST

BMO Financial Group (NYSE, TSX: BMO) is an integrated financial services provider offering a range of retail banking, wealth management, and investment and corporate banking products. BMO serves Canadian retail clients through BMO Bank of Montreal and BMO Nesbitt Burns. In the United States, personal and commercial banking clients are served by BMO Harris Bank N.A., (Member FDIC). Investment and corporate banking services are provided in Canada and the US through BMO Capital Markets.

BMO Capital Markets is a trade name used by BMO Financial Group for the wholesale banking businesses of Bank of Montreal, BMO Harris Bank N.A. (member FDIC), Bank of Montreal Europe p.l.c., and Bank of Montreal (China) Co. Ltd, the institutional broker dealer business of BMO Capital Markets Corp. (Member FINRA and SIPC) and the agency broker dealer business of Clearpool Execution Services, LLC (Member FINRA and SIPC) in the U.S., and the institutional broker dealer businesses of BMO Nesbitt Burns Inc. (Member Investment Industry Regulatory Organization of Canada and Member Canadian Investor Protection Fund) in Canada and Asia, Bank of Montreal Europe p.l.c. (authorised and regulated by the Central Bank of Ireland) in Europe and BMO Capital Markets Limited (authorised and regulated by the Financial Conduct Authority) in the UK and Australia.

© Registered trademark of Bank of Montreal in the United States, Canada and elsewhere.

™ Trademark Bank of Montreal in the United States and Canada.

© COPYRIGHT 2020 BMO CAPITAL MARKETS CORP.

A member of BMO Financial Group