May and Macklem's Day

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Good riddance to April 2020, which may well ultimately rank as one of the worst months for the global economy… *ever.* Amid the near total lockdown of North America, as well as much of Europe and still big parts of Asia, the economic damage will be staggering. The specifics on that are just now beginning to trickle in, with the U.S. manufacturing production ISM dropping to 27.5 in the month, auto sales plunging to around a third of the pre-virus trend of 17 million, and 28 million Americans filing jobless claims in the past six weeks alone. Globally, Korea reported a 24% y/y drop in exports last month, while Europe continues to struggle after a wave of double-digit GDP declines in Q1 across the continent.

Yet, financial markets are famously forward-looking, and even **as the global economy was writhing, equities were thriving** last month. The S&P 500 managed to rebound 12.7% in April, its best month since January 1987, while the broader MSCI world index popped 10.5%. This brought the global index 27% above its March lows, but left it down 16% from the February peak. Notably, the TSX was heading for its sixth consecutive weekly gain by mid-Friday, even with a late-week stumble.

Markets generally took a pause after the furious April rally, perhaps on a sense that things had come too far, too fast—the S&P 500, for instance, had climbed all the way back to year-ago levels by Wednesday. While enthused by some positive results on Gilead's anti-viral drug Remdesivir, investors were also cooled by some cautionary guidance by key tech companies as well as the dawning realization that the road to recovery remains long and difficult. For example, the latest Blue Chip survey of professional forecasters found that 76% believe that the economic bottom will be in April (and 16% in May); and yet, the consensus view is that the recession will last 6 months, which would take us into the end of the summer.

Adding another twist to market sentiment was President Trump's musings about new possible tariffs on China (in his words, as punishment for their handling of COVID-19). One of the rare positives for the outlook early this year was the temporary truce on the U.S./China trade war. Harkening back to the good old days of last year, the trade battle had been the biggest single issue for the global economy, so the better tone on that front had brightened growth prospects considerably. Suffice it to say, any new threat to that separate peace is the last thing a troubled global economy needs at this point.

Circling back to the economic hit from the virus, the U.S. reported its second biggest quarterly GDP decline in the past 35 years in Q1, when it fell at a 4.8% annual rate. Three keys points are: 1) the savings rate shot higher late in Q1, as spending fell much faster than income. That can be seen as support for the view that consumers will be well-poised to support the recovery when they are willing and able to venture out again; 2) But, the deep Q1 drop is just a taste of what's to come, given that the shutdowns really only began in earnest in the final few weeks of the quarter. We continue to expect roughly a 12% drop in Q2 (or a 40% annualized decline); and 3) The

Q1 GDP drop in the U.S. was one of the mildest declines in the world, as most major economies dealt with earlier shutdowns.

On that front, the Euro Area economy saw GDP fall at a 14.4% annual rate, with notable weakness in France (-21.4%), Spain (-19.4%) and Italy (-17.7%). While not official, the estimate on a comparable basis for China, the first economy to lock down, was a drop of just over 36%. And, earlier, StatsCan had already given a flash estimate that Canada's GDP fell at a 10% annual rate in the first quarter—more than double the speed of the decline in the U.S. economy, a curiously wide gap.

Next week's economic highlight, or more likely the lowlight, will be the April employment reports for both Canada and the U.S. on Friday. Make no mistake that markets are well-primed for incredibly ugly results, dwarfing even the massive job losses reported for March (when Canada, for instance, lost 1 million jobs). Double-digit jobless rates beckon, at least based on the dramatic swell in people applying for benefit programs. In Canada alone, there have been more than 7 million unique applications for the new CERB, which represents a massive 35% of the labour force. Let's hope that T.S. Eliot was correct that April was indeed the cruellest month.

Amid the seemingly ceaseless onslaught of unprecedented and disruptive events this year, Friday brought a welcome and long-scheduled piece of news—a new Bank of Canada Governor. **Tiff Macklem** was selected, and he will assume the reins in early June for a seven-year term. He was the Senior Deputy Governor under Mark Carney, and had been widely seen as a leading candidate for the Governor position back in 2013 when Stephen Poloz was selected. While this marks the fourth consecutive time that the government of the day has decided to select someone other than the sitting Senior Deputy Governor, Macklem is by no means an outsider, with lengthy experience at the Bank as well as at Finance during the 2008 crisis.

On a personal note, I will shamelessly point out that Macklem was a classmate of mine (as well as Michael Gregory's) for one year in post-graduate studies at the University of Western Ontario. Given that this was a few decades ago—okay, more like a handful—it's not like this gives us an inside track into looking deep into Tiff's mindset.

Nevertheless, Macklem did tip his hand on at least one key question during today's press conference; he **definitely sounded less than enthusiastic about the prospect of negative interest rates**, suggesting that such a move could simply add to instability at an unstable time. More generally, it seems that the Bank has, in general, cooled considerably on negative rates, probably largely in response to the mixed/unfavourable experience of Europe.

How might policy be different than under Governor Poloz? It's probably fair to say that **Macklem will be less focussed on the Canadian dollar than Poloz, although that does not imply he will be less dovish**. (Arguably, there were at least a few episodes in recent years when the Bank did not cut rates due to concerns that the currency was falling too rapidly.) In fact, the loonie did take a small step lower on the official announcement that Macklem had the job, but that probably says more about the fact that the perceived leading candidate wasn't selected, rather than a statement on any big potential changes in Bank policy. It's probably also fair to say that there will

be fewer colourful metaphors in official speeches. But beyond that, policy is already essentially at full-easing bore, with rates at the lower boundary, QE now in full force, and liquidity provisions aplenty. The next big decision for policymakers at the Bank will be when to start turning down the flow of liquidity—but we suspect that's a decision that won't be made until well into 2021.

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