BMO Capital Markets Economics | A Weekly Financial Digest

July 3, 2020

Focus

Feature Article

Questions the Fiscal Update *Won't* Answer

Our Thoughts

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The Recovery's Alphabet Soup

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Almost since the day the North American economy began to shut down in earnest in March, a key question for markets has been: **What shape the economic recovery will take: V, U, W, L, or a more exotic one like a Z, K, swoosh or even a reverse square root**? Well, at the half-way point in the year, we now have the definitive answer: **Yes**. Yes, as in we will have a recovery; but, **depending on the industry, the country, the region, or even the individual business, it may be facing any one of those shapes**. We have maintained all along that the overall economy will not fit neatly into any one of these patterns, and the evidence two months into the recovery bears this out. And, in most cases, it's the virus and its impact that will largely dictate the pace of recovery.

Financial markets reverted to their near-V-shaped pattern, with the S&P 500 firing back up 4% in the holiday-shortened week (and down just 3% YTD), while the Nasdaq finished at a new all-time high. Oil prices also firmed notably, with both WTI and Brent reaching levels not seen since early March at above $40. Copper prices have seen an even more spirited revival, with supply issues and prospects of a global manufacturing recovery driving them above year-ago levels in a nearly perfect V from the March lows. Of course, the major outlier remains bond yields, which most resemble an L shape, although even 10-year Treasury yields crept up 3 bps this week to 0.67%.

Some have suggested that markets are currently engaged in an epic **tug-of-war**, with lavish policy support pulling on one end, and the vicious flare-up in virus cases anchoring the other end. Policy continues to gradually win most of the battles, even in the face of news that U.S. daily cases sprinted above a record 50,000 this week. While this serious upswing has caused a partial reversal in economic openings in some key states, markets are maintaining their cool amid progress on potential vaccines, a more contained rise in hospitalizations and mortalities, as well as generally upbeat economic news. But, despite the market's sunny disposition, there is little debate that the **resurgence of COVID cases is a massive disappointment**, and pretty much officially rules out the prospect of a V-shaped recovery for the overall U.S. economy.

That development is a true shame, because many of the early indicators for June gave a tantalizing hint that **a V was still a real possibility**. The headline act was the **June jobs report**, which again topped all expectations with a hefty 4.8 million advance and a steep 2.2 ppt drop in the unemployment rate to 11.1%. While both the job increase and jobless rate decline shattered records, the harsh reality is that only about a third of the employment losses from the shutdown have been recouped so far. The **manufacturing ISM index** also blew away expectations, jumping 9.5 points to above the 50 line, and to its best level in a year at 52.6. **Vehicle sales** also continued to recover, rising to 13.2 million units last month, albeit still well down from last year's average of 17 million. The big counterpoint to the generally solid results is the persistently sky-high level of **jobless claims**, both initial and continuing. Despite plenty of misgivings about almost any metric of the labour market at this point, there's little debate that **19.3 million continuing jobless claims are a problem** at more than tenfold the pre-virus trend.

Our mass of **real-time economic data** is sending a similar positive, albeit mixed message. On the strong side of the ledger in recent weeks for the U.S. have been small business revenues, hotel occupancy, and business formation. However, on the weak side has been, not surprisingly, a reversal in some states in OpenTable reservations, amid the renewed restaurant and bar restrictions in some regions. The overall macro picture appears to be a quick mechanical bounce in industries that have been able to open, but now the prospect of a much slower, grinding recovery for other sectors that face ongoing restraints. As mentioned, that picture doesn't fit neatly into any of the letter patterns.

Canada's economy is largely following roughly the same broad pattern, albeit with quite a different experience with the virus rumbling away in the background. After even deeper slides in vehicle sales and consumer confidence than in the U.S. during the lockdown, Canada is now predictably reporting bigger snapbacks. And while the April GDP report this week is nearly ancient history, it provided the official reading on just how deep the two-month downturn was (down 18.2% from the February peak). As well, StatsCan estimates that the economy grew by 3% in May, in the early stages of recovery. This combination left our forecast intact, with a 40% annualized Q2 drop leading to a 6% setback for 2020 GDP.

The **June jobs report** for Canada is due next Friday, capping what should be an eventful summer week for domestic economic news. The Bank of Canada will release its **Q2 Business Outlook Survey** on Monday; it could be all over the map, given that it was conducted about a month ago, with some readings at dire lows, but others possibly pointing to serious recovery prospects. Wednesday will bring the long-awaited **fiscal snapshot** from Finance Minister Morneau; although, as we assert in this week's Focus Feature, it will likely leave many big fiscal questions unanswered. For employment, Canada has roughly mimicked the U.S. experience recently, with the old 10:1 rule holding up remarkably well during this period of extreme economic volatility, and we expect that to continue in June with a job gain of 450,000.

Even in the event of a strong job rise last month, we still expect Canada's unemployment rate to stay high at nearly 13%. If correct, that would leave the jobless rate more than 7 percentage points higher than a year ago, roughly similar to the net deterioration seen in the U.S. job market. One notable development is that this massive backup in the unemployment rate is very specific to North America. Even as every economy in the world has been grappling with deep, deep downturns, **no other country has seen anything close to the surge in joblessness**. For example, the Euro Area's jobless rate ticked up to just 7.4% in May, only 0.3 ppts above the recent low… and still *down* from year-ago levels. Australia, Sweden and Japan have seen jobless rates rise notably, but none have posted increases as much as 2 percentage points in the past year. The only other OECD economy where the unemployment rate has risen by more than 2 ppts is tiny Iceland, where it has doubled to a still moderate 7.6%. Clearly, the rest of the world has been much more successful in keeping employees attached to employers, and raises the chances that their economies may witness something closer to a V-shaped recovery—provided the virus remains at bay there—than in North America over the next year.

One clear and direct benefit of Canada's relatively less negative experience with the virus than the U.S. emerged this week. By all accounts, the **NHL playoffs** will be held in the Hub cities of Edmonton and Toronto, assuming all systems are still go. True, the economic impact will be modest (and that may be a generous description). With roughly 50 people arriving with each of the 12 teams, that means each city will reap a grand total of 600 visitors. Much more importantly, it will put to bed forever talk that Toronto will never again see playoff hockey in the summer. All it took was a global pandemic…

U.S. Labour Market: Now the Hard Work Begins

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The spring turned out better than many, including us, expected for U.S. workers who were rocked by the deep two-month recession. The return of 7.5 million workers in May and June from mostly temporary layoffs cut the jobless rate by 3.6 ppts since April. Alas, that's largely where the good news ends. The recovery has reversed just one-third of the 22 million jobs lost in the lockdowns and a similar proportion of the 11-ppt spike in the unemployment rate. There are still nearly 18 million people unemployed, 12 million more than in February. The jobless rate is still in double digits at 11.1%, though that's not as scary as April's postwar high of 14.7%. More concerning, recent data and events suggest **recovering the remainder of the job losses will take much longer than suggested by the progress of the past two months**.

The rate of job growth looks to moderate in coming months. **First, jobless claims remain in nosebleed territory**—initial (1.4 million), continuing (19.3 million) and Pandemic Unemployment Assistance (12.9 million). The total level of filings from all state programs hit a record 31.5 million in the week of June 13, and recent filings suggest little progress since then. In fact, Florida and Texas look to have reported higher initial claims in the current week.

Second, permanent job losses rose a further 0.6 million in June, bringing the four-month rise to 1.6 million. Although the increase is just a third of the 4.8 million that occurred in the Great Recession, it's an unsettling reminder of insolvencies and weak demand in industries that are still struggling under government-mandated restrictions or consumer health fears, restaurants being a prime example. Seated diners in states seeing a surge in infections have partly reversed recent gains according to OpenTable.

Third, the bulk of the recovery in payrolls was in the hardest-hit sectors, notably food services (2.9 million since April) and retail (1.1 million), **which are now at greatest risk of renewed layoffs due the resurgence in cases.** California and Texas are reclosing bars and indoor dining.

And **fourth, some timelier jobs data are disappointing**. The Dallas Fed's real-time population measure of the employment rate (which is based on an online survey that mimics the BLS's methodology) fell modestly in the July 4 week from mid-June. Job trends in retail and food services have reversed recently according to Homebase, while some previously opened businesses have closed again in Texas, Florida, and Arizona, states that are seeing the largest rise in infections.

Based on our outlook, **employment could take until late 2022 to return to pre-virus levels**. That's 2½ years, compared with just over 4 years to recover the lost jobs in the Great Recession. Meantime, the unemployment rate could remain around 9% at year's end and north of 5% even two years from now. On the surface, the better job numbers in the Great Reopening would suggest an upward revision to our forecast. But the devil is in the details, and the recent flare-up in infections is disturbing enough to dampen any sense of optimism.

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Indications of stronger growth and a move toward price stability are **good news** *for the economy.*

	Good News	Bad News
Canada ▪ Fitch downgrades Alberta's credit rating to AA- from AA	**Merchandise Trade Deficit** narrowed sharply to $677 mln (May) **Building Permits** +20.2% (May) **Industrial Product Prices** +1.2%; **Raw Material Prices** +16.4% (May) **Market Manufacturing PMI** +7.2 pts to 47.8 (June) **Conference Board's Consumer Confidence Index** +16.0 pts to 79.7 (June)	**Monthly Real GDP** -11.6% (Apr.)—but +3.0% expected for May **Auto Sales** -16.2% y/y (June)
United States ▪ FOMC Minutes show policy will remain "*highly accommodative*" for some time ▪ S&P 500 ends second quarter with best gains since 1998 ▪ Rising COVID cases derail re-openings	**Nonfarm Payrolls** +4,800,000 (June) **Jobless Rate** -2.2 ppts to 11.1% (June) **Initial Claims** -55k to 1,427k (June 27 week) **Auto Sales** +8.1% to 13.15 mln a.r. (June) **ISM Manufacturing** +9.5 pts to 52.6 (June) **Factory Orders** +8.0% (May) **S&P Case-Shiller Home Prices** +4.0% y/y (Apr.) **Pending Home Sales** +44.3% (May) **Conference Board's Consumer Confidence Index** +12.2 pts to 98.1 (June); **CEO Confidence Index** +8 pts to 44 (Q2)	**Continuing Claims** +59k to 19,290k (June 20 week) **Average Hourly Earnings** -1.2% (June) **Construction Spending** -2.1% (May) **Goods & Services Trade Deficit** widened to $54.6 bln (May)
Japan ▪ New virus cases rising in Tokyo	**Retail Sales** +2.1% (May) **Manufacturing PMI** revised up to 40.1; **Services PMI** revised up to 45.0 (June) **Consumer Confidence** +4.4 pts to 28.4 (June)	**Industrial Production** -8.4% (May P) **Jobless Rate** +0.3 ppts to 2.9% (May) **Tankan Large Mfg. Index** -26 pts to -34 (Q2)
Europe ▪ EU/UK trade talks end early amid "*significant differences*" ▪ French Pres. Macron shuffles government; Jean Castex named new PM	**Euro Area—Economic Confidence** +8.2 pts to 75.7 (June) **Euro Area—Consumer Prices** +0.3% y/y (June P) **Euro Area—Manufacturing PMI** revised up to 47.4; **Services PMI** revised up to 48.3 (June) **Germany—Retail Sales** +13.9% (May) **France—Consumer Spending** +36.6% (May) **France—Jobless Rate** -0.6 ppts to 8.1% (May P) **U.K.—Services PMI** revised up a tick to 47.1 (June)	**Euro Area—Jobless Rate** +0.1 ppts to 7.4% (May) **Germany—Unemployment** +69,000 (June)—and **Jobless Rate** +0.1 ppts to 6.4% **Italy—Jobless Rate** +1.2 ppts to 7.8% (May P) **U.K.—Real GDP** revised lower to -2.2% q/q (Q1) **U.K.—Nationwide House Prices** -1.4% (June)
Other ▪ Beijing passes Hong Kong national security law	**China—Manufacturing PMI** +0.3 pts to 50.9; **Non-manufacturing PMI** +0.8 pts to 54.4 (June) **China—Caixin Manufacturing PMI** +0.5 pts to 51.2; **Services PMI** +3.4 pts to 58.4 (June) **Australia—Retail Sales** +16.9% (May) **Australia—Trade Surplus** widened to A$8.0 bln (May)	**Australia—Building Approvals** -16.4% (May)

Questions the Fiscal Update Won't Answer

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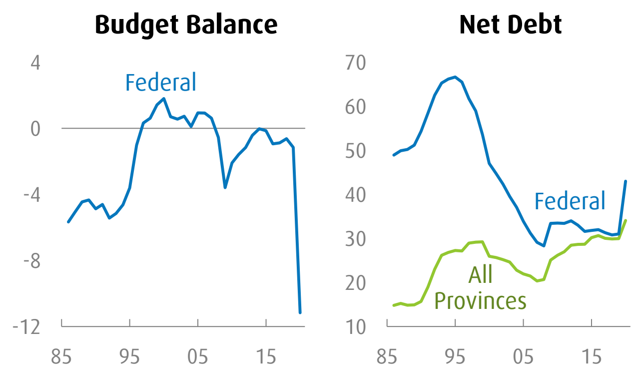
Ottawa's fiscal "snapshot" on July 8 will be the first official update of federal government finances since the pre-pandemic days of late last year. Instead of a near-2% growth rate for 2020, we are now looking at a decline of at least 6% (latest consensus is -6.6%). Along with the steep pullback in oil and other commodity prices, that 8 percentage point swing in the GDP outlook has carved a canyon in government revenues. With massive spending on much-needed income support measures added on, the budget deficit will likely swell to over $250 billion (or more than 11% of GDP) in this fiscal year, versus pre-virus estimates of just under $30 billion (close to 1% of GDP). This will bump up the debt/GDP ratio from just over 30% to roughly 44% in one fell swoop *(Chart 1)*. And that's before any additional measures that may be announced in coming months to help support and reinforce the recovery. These points are likely to be the main thrust of what the fiscal update will address, but here are some key questions that *won't* be addressed:

1) How are we going to ultimately pay for this?

Fitch's downgrade of Canada's credit rating on June 24 was a stark reminder that there are indeed limits to how far the fiscal taps can be opened during this extreme economic event. But while we have little quarrel with Fitch's logic, there are a few points to make in considering how quickly the fiscal support measures need to be reversed in coming years. First, because of record low bond yields, and negative in real terms, the interest cost of the rising debt burden is very modest; we're in a different world than the bad old days of the 1980s/90s *(Chart 2)*. Second, the vast majority of the temporary rise in Ottawa's new debt is being absorbed by the Bank of Canada. And, while the BoC's holdings of federal government debt as a share of the total has risen abruptly from less than 14% at the start of the year to around 27% now *(Chart 3)*, that's still below the share of domestic government debt held by central banks in Japan, Germany and Sweden, for example. Third, Canada's overall public sector net debt remains moderate among major economies, and especially when compared to the U.S., Britain, or the Euro Area *(Chart 4)*.

Chart 1
Deep Into the Red

Canada (fiscal year-end : % of GDP)

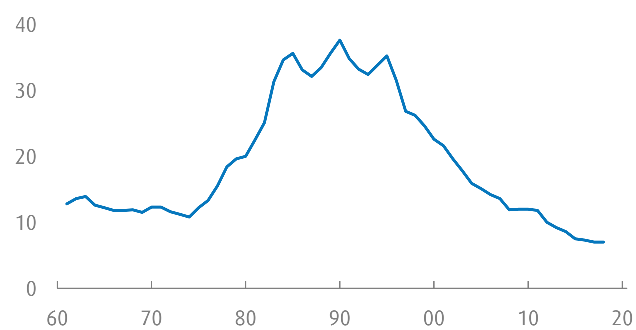


Sources: FY20/21 is BMO Economics est.; federal budgets/fiscal updates

Chart 2
Little Interest

Canada — Federal Government (fiscal years : %)

Gross Public Debt Charges as a Percent of Revenues



Sources: BMO Economics, Haver Analytics

The main point is that, while deficits of over 10% of GDP are simply not sustainable for long, Ottawa should aim to bring down the deficit only insofar as it doesn't threaten the fledgling recovery. A gradual glide-path back toward smaller deficits is entirely appropriate, and manageable from a long-term fiscal sustainability lens, particularly as long as bond yields remain firmly planted below inflation. At anything close to current long-term interest rates, deficits of 2%-to-3% of GDP are sustainable, and would stabilize debt ratios at around 50% of GDP.

2) Who will pay for this? Higher taxes or spending cuts?

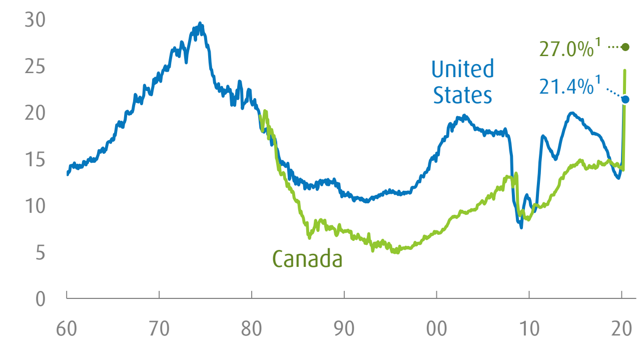
Our core view is that the emphasis should be entirely on ensuring that the recovery first takes hold before any consideration is given to restraint measures. Some of the one-time fiscal costs will naturally roll off as the economy begins to recover (and, to be clear, this is not spending restraint or cuts, just an end to emergency measures). Along with some underlying recovery in economic activity and revenues, this will go a long way to reducing the deficit to more manageable levels by next year, closer to $100 billion, or around 4% of GDP. That's still considerably larger than pre-virus trends of about 1% of GDP, and would lead to some upward drift in debt ratios.

Given that the unemployment rate is likely to still be well above pre-virus levels when the economy ultimately emerges on the other side of the pandemic, any serious spending restraint will be a very tough sell. Program spending had only just returned to its long-run trend in the prior fiscal year *(Chart 5)*. However, we would assert that the economic argument for any tax increases is also very thin—Canada already has one of the highest top marginal tax rates in the world, and is no longer notably competitive on corporate rates, while higher sales taxes are nearly a non-starter. But that's the economic argument; the political argument is an entirely different matter in current circumstances.

The bottom line to these two questions is that we are unlikely to reverse the one-time damage to debt/GDP —so it's a one-time deterioration in government debt tallies that will mostly "pay" for this. Still, ultimately, some moderate fiscal tightening will eventually be required to stabilize debt ratios.

Chart 3
Central Bank Holdings of Government Debt: Waxing

(% of total bonds and bills)

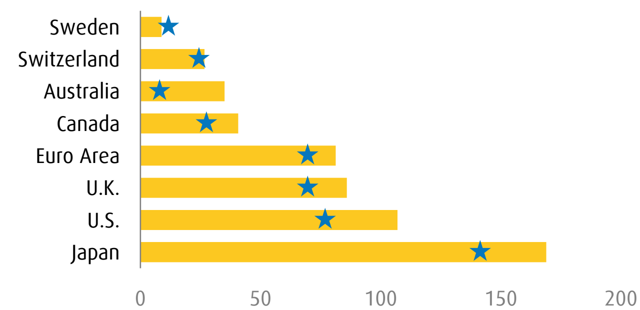


Sources: BMO Economics, Haver Analytics [1] *June 2020 estimate*

Chart 4
Canada in the Middle

2020 (% of GDP)

General Government Net Debt

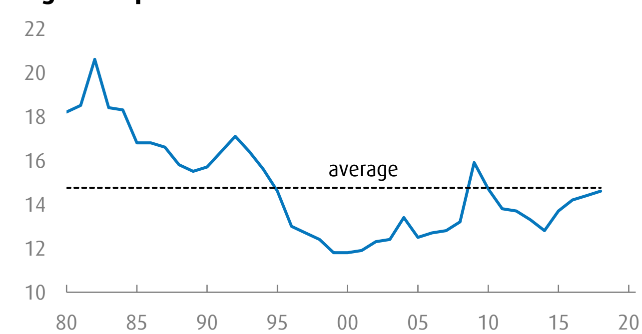


Sources: BMO Economics, IMF Fiscal Monitor 2020 ★ *= 2011*

Chart 5
Pre-Virus Spending: Back to Normal

Canada — Federal Government (fiscal years : %)

Program Expenses as a Percent of GDP



Sources: BMO Economics, Haver Analytics

3) What will happen when programs expire?

A big concern for the recovery is what happens when massive federal support programs start to expire. The CERB, for example, has served more than 8 million unique applicants with $2,000/month. Ottawa was already faced with a concerning situation whereby many CERB recipients were set to begin falling out of the program in early July as their 16-week payment period came to an end. Presumably, some could shift into the EI program, but eligibility would vary and lead to dropped coverage. Not wanting to subject the economy to a negative shock just as it is re-opening, Ottawa extended the program by another 8 weeks, which will take initial recipients into early-September. The CEWS was also already extended once (by 12 weeks), and the commercial rent relief program was extended by a month, to cover July. Suffice it to say that some sectors won't be nearly back to pre-COVID capacity even when these extensions run their course, so many Canadians will slip into a tougher financial situation. That said, these three benefit programs alone are now expected to cost almost $130 billion in FY20/21, with the tab growing each time a program is extended. Therefore, Ottawa will have a tradeoff to make between maintaining support and digging deeper into deficit—so far, it's been the latter.

A separate aspect is mortgage deferrals, where Ottawa is not bearing a direct fiscal cost; but, more than 15% of mortgages have seen some deferral, according to CMHC. This six-month deferral period will also begin to wind down for early applications in the fall and, while there won't be an outsized payment waiting at the other end, interest continues to accumulate on the outstanding balances, increasing debt-to-income ratios.

4) What will the next phase of fiscal policy look like?

Fiscal policy so far during the pandemic can be characterized as a group of measures to help maintain solvency—keeping households able to pay their bills, and small businesses in place to reopen when eventually allowed. As the pandemic fades, presumably policy will shift more toward incenting growth, job market participation and business creation (or re-creation) in order to help push the economy back to capacity. Some provinces, for example, have already pulled forward capital spending dollars and even cut tax rates. While the next phase is probably not something that will be covered in the upcoming fiscal update (2021 budget, perhaps), it will likely take on a more traditional stimulus feel, with the biggest new wrinkle being measures to pull people back into the labour market after (in some cases) 6 months of generous government support. We don't believe tax increases should, or will, be a part of fiscal policy through the next phase. But, the longer-term challenge of rebuilding fiscal capacity will inevitably be waiting at the end of the recovery period. At that point, one has to assume that some targeted tax increases will be coming, at least if the current political backdrop remains.

5) Will interest rates start to rise with all the new borrowing and/or the credit rating downgrade?

The straightforward answer is "no". It's notable that 10- and 30-year GoC bond yields actually managed to dip further in the days after the Fitch downgrade (albeit by a bit less than Treasury yields slid). This included a near-record low for the 10-year yield, before a small rebound, and 30-year yields close to just 1%. And that's even with Finance Minister Morneau mooting about leaning more to longer-term issuance. This simply drives home the reality that financial markets tend to be far ahead of ratings agencies, providing their own version of relative ratings in real time.

While we look for some modest upward drift in bond yields over the next year as the global economy gradually recovers, any major move in rates seems a long way off. The Bank of Canada has a variety of policy options at its disposal to make sure that yields don't lurch higher, and potentially threaten the recovery. In order of likelihood, the Bank could potentially: a) re-introduce explicit forward guidance (something former Governor Poloz eschewed); b) intensify bond buying; or, c) introduce yield curve control/caps (as the Bank of Japan and the Reserve Bank of Australia have done). Given the likelihood of a still-wide output gap, muted core inflation pressures, and the wide variety of potential BoC tools, we suspect that any back-up in yields won't last long. The net result of the pandemic for rates will most likely be even lower for even longer, a critical element in containing the fiscal costs of supporting the economy through this extremely difficult episode.

Economic Forecast Summary for July 3, 2020

		2020				2021				Annual		
		Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	2019	2020	2021
CANADA												
Real GDP	(q/q % chng : a.r.)	-8.2	-40.0	42.0	10.0	7.0	4.2	2.5	2.5	1.7	-6.0	6.0
Consumer Price Index	(y/y % chng)	1.8	-0.2	0.1	0.2	0.5	2.1	1.8	1.7	1.9	0.4	1.5
Unemployment Rate	(percent)	6.3	12.9	9.7	9.2	8.6	8.1	7.7	7.4	5.7	9.5	8.0
Housing Starts	(000s : a.r.)	208	182	183	189	205	205	220	228	209	190	215
Current Account Balance	($blns : a.r.)	-44.4	-72.8	-71.4	-67.5	-64.1	-62.5	-60.2	-59.2	-47.0	-64.0	-61.5
Interest Rates		(average for the quarter : %)										
Overnight Rate		1.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	1.75	0.50	0.25
3-month Treasury Bill		1.29	0.22	0.20	0.20	0.20	0.20	0.20	0.20	1.65	0.45	0.20
10-year Bond		1.20	0.59	0.65	0.80	0.90	1.00	1.05	1.15	1.59	0.80	1.00
Canada-U.S. Interest Rate Spreads		(average for the quarter : bps)										
90-day		16	8	3	3	3	3	3	3	-45	7	3
10-year		-18	-10	-16	-15	-13 ↑	-12	-11	-10	-56	-14 ↑	-12
UNITED STATES												
Real GDP	(q/q % chng : a.r.)	-5.0	-40.0	36.0	7.0	5.9	5.2	4.1	3.2	2.3	-5.5	5.0
Consumer Price Index	(y/y % chng)	2.1	0.5	0.7	0.6	0.8	2.0	1.7	1.6	1.8	1.0	1.5
Unemployment Rate	(percent)	3.8	13.0	9.8	9.0	8.1	7.3	6.6	6.2	3.7	8.9	7.0
Housing Starts	(mlns : a.r.)	1.48	1.00	1.25	1.31	1.28	1.29	1.29	1.30	1.30	1.26	1.29
Current Account Balance	($blns : a.r.)	-417	-558	-593	-612	-624	-630	-639	-647	-480	-545	-635
Interest Rates		(average for the quarter : %)										
Fed Funds Target Rate		1.13	0.13	0.13	0.13	0.13	0.13	0.13	0.13	2.13	0.38	0.13
3-month Treasury Bill		1.13	0.14	0.15	0.15	0.15	0.15	0.15	0.15	2.10	0.40	0.15
10-year Note		1.38	0.69	0.80	0.95	1.05	1.10	1.15	1.25	2.14	0.95	1.15
EXCHANGE RATES		(average for the quarter)										
US¢/C$		74.4	72.2	73.9	74.0	74.3	74.5	74.8	75.1	75.4	73.6	74.7
C$/US$		1.34	1.39	1.35	1.35	1.35	1.34	1.34	1.33	1.33	1.36	1.34
¥/US$		109	108	108	110	111	112	113	115	109	109	113
US$/Euro		1.10	1.10	1.13	1.15	1.15	1.15	1.16	1.16	1.12	1.12	1.16
US$/£		1.28	1.24	1.25 ↓	1.26 ↑	1.27 ↑	1.28 ↑	1.29 ↑	1.30	1.28	1.26	1.28

Blocked areas mark BMO Capital Markets forecasts; up and down arrows (↑↓) indicate forecast changes; spreads may differ due to rounding

Canada

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BoC Business Outlook Survey and Survey of Consumer Expectations (Q2)

Monday, 10:30 am

The Bank of Canada's summer **Business Outlook Survey (BOS)**, likely compiled from around mid-May to mid-June, is expected to show a sharp deterioration in sentiment despite being past the worst of the COVID impact. The prior survey only caught the beginning of the pandemic. Look for every aspect of the BOS to fall drastically.

There likely won't be many (if any) positives in this report, with employment, sales, and investment all falling sharply. Expect a slew of supplemental questions in this edition of the BOS in an attempt to assess the speed of the recovery. And, credit conditions might show a bit of a mixed picture as interest rates have come down but the pandemic-related slowdown in activity likely caused some tightening of credit for a number of firms.

Capacity pressures began to drop in Q1, but there will likely be a much deeper decline in this survey. A broad-based plunge in demand globally is the problem, which along with a surge in unemployment, suggests capacity pressures won't be an issue for some time. Indeed, we don't expect GDP to return to 2019Q4 levels until the end of 2021, suggesting there will be disinflationary slack for at least the next couple of years. The outlook for input and output price inflation might be more interesting than usual. Input prices have seen wild swings in commodities, while global production shutdowns in a number of goods might cause some firms to note rising prices. Output prices also face additional costs to operate under COVID restrictions, so we could see some strength despite the huge amount of slack in the economy. Overall, the tone of the survey is expected to be very downbeat, though some of the supplemental questions will no doubt focus on recovery prospects which could provide a silver lining.

The Bank's **Consumer Expectations Survey** will be out at the same time (this new survey was first published in January), and likely won't look any better. Massive job losses in March and April will weigh heavily on sentiment, though the government income support measures might provide some lift.

Economic and Fiscal Snapshot

Wednesday

See this week's Feature article, "Questions the Fiscal Update *Won't* Answer", on page 6.

Employment

Friday, 8:30 am

June (e)	**+2.7% (+450,000)**
May	+1.8% (+289,600)
	Unemployment Rate
June (e)	**12.8%**
May	13.7%
	Average Hourly Wages
June (e)	**+8.5% y/y**
May	+10.5% y/y

The recovery continued in June, as COVID restrictions were eased throughout much of the country. We're looking for a 450,000 increase in **employment**, building on the near-300k rise in the prior month. Unfortunately, that reverses only one-quarter of the plunge seen in March and April. With Canada, and Toronto in particular, opening up a bit more cautiously than much of the U.S., we could see an even bigger increase in July. However, some sectors aren't likely to bounce back soon, with tourism still under huge pressure, entertainment still largely shut, and retail opening with significant restrictions on traffic. Assuming a modest increase in the participation rate as some discouraged workers return, our call would pull the jobless rate down to 12.8% from the prior month's record 13.7%. Watch hours worked for a glimpse into how quickly the rebound is unfolding.

United States

Sal Guatieri,
Senior Economist
sal.guatieri@bmo.com

Non-manufacturing ISM (NMI)
Monday, 10:00 am

June (e)	**50.0**
Consensus	*50.0*
May	45.4

Improved regional measures suggest the **ISM non-manufacturing index** rose to 50.0 in June from 45.4 in May and an 11-year low of 41.8 in April as most states continued to ease restrictions prior to the recent flare-up in infections. Less-impacted sectors such as utilities and professional/technical services have partly offset the devastating losses in the leisure and hospitality sector. Other countries, including China and across Europe, are also seeing a solid bounce in services activity in the wake of pent-up demand (e.g., for haircuts). Limiting the expected increase in June will be a further sag in oil production and shorter delivery times. The strong gain in nonfarm payrolls flags a decent advance in the jobs sub-index. Many more industries likely reported growth in June than the 4 (of 18) in May, and the tone of the commentary should be much less somber. Still, we'll be watching for any hint of backsliding caused by the recent resurgence in infections.

Financial Markets Update for July 3, 2020

		Jul 3 [1]	Jun 26	Week Ago	4 Weeks Ago	Dec 31, 2019
					(basis point change)	
Canadian Money Market	Call Money	0.25	0.25	0	0	-150
	Prime Rate	2.45	2.45	0	0	-150
U.S. Money Market	Fed Funds (effective)	0.25	0.25	0	0	-150
	Prime Rate	3.25	3.25	0	0	-150
3-Month Rates	Canada	0.20	0.20	0	2	-146
	United States	0.14	0.14	0	-1	-141
	Japan	-0.09	-0.10	1	2	2
	Eurozone	-0.44	-0.40	-3	-8	-5
	United Kingdom	0.11	0.14	-3	-11	-68
	Australia	0.10	0.11	0	0	-81
2-Year Bonds	Canada	0.30	0.29	1	-5	-140
	United States	0.15	0.17	-1	-6	-142
10-Year Bonds	Canada	0.55	0.51	4	-18	-115
	United States	0.67	0.64	3	-23	-125
	Japan	0.03	0.01	2	-2	5
	Germany	-0.43	-0.48	5	-15	-24
	United Kingdom	0.19	0.17	2	-16	-63
	Australia	0.90	0.87	4	-19	-47
Risk Indicators	VIX	27.7	34.7	-7.1 pts	3.2 pts	13.9 pts
	TED Spread	14	17	-3	-3	-23
	Inv. Grade CDS Spread [2]	74	81	-6	9	29
	High Yield CDS Spread [2]	505	531	-26	78	225
					(percent change)	
Currencies	US¢/C$	73.66	73.06	0.8	-1.1	-4.3
	C$/US$	1.358	1.369	—	—	—
	¥/US$	107.50	107.22	0.3	-1.9	-1.0
	US$/€	1.1244	1.1219	0.2	-0.4	0.3
	US$/£	1.246	1.234	1.0	-1.6	-6.0
	US¢/A$	69.36	68.65	1.0	-0.5	-1.2
Commodities	CRB Futures Index	140.60	134.41	4.6	1.2	-24.3
	Oil (generic contract)	39.95	38.49	3.8	1.0	-34.6
	Natural Gas (generic contract)	1.74	1.54	12.4	-2.6	-20.7
	Gold (spot price)	1,775.24	1,771.29	0.2	5.4	17.0
Equities	S&P/TSX Composite	15,597	15,189	2.7	-1.6	-8.6
	S&P 500	3,130	3,009	4.0	-2.0	-3.1
	Nasdaq	10,208	9,757	4.6	4.0	13.8
	Dow Jones Industrial	25,827	25,016	3.2	-4.7	-9.5
	Nikkei	22,306	22,512	-0.9	-2.4	-5.7
	Frankfurt DAX	12,521	12,089	3.6	-2.5	-5.5
	London FT100	6,153	6,159	-0.1	-5.1	-18.4
	France CAC40	4,998	4,910	1.8	-3.8	-16.4
	S&P ASX 200	6,058	5,904	2.6	1.0	-9.4

[1] = as of 10:45 am *[2] = One day delay*

	Monday July 6	Tuesday July 7	Wednesday July 8	Thursday July 9	Friday July 10
Japan		**Household Spending** **May (e) -11.8% y/y** Apr. -11.1% y/y	**Bank Lending Ex-Trusts** **June** May +5.1% y/y **Current Account Surplus** **May '20 (e) ¥1.1 trln** May '19 ¥1.6 trln	**Core Machine Orders** **May (e) -3.2% -16.8% y/y** Apr. -12.0% -17.7% y/y **Machine Tool Orders** **June P** May -52.8% y/y	
Euro Area	**EURO AREA** **Retail Sales** **May (e) +15.0% -7.5% y/y** Apr. -11.7% -19.6% y/y **GERMANY** **Factory Orders** **May (e) +15.0% -26.0% y/y** Apr. -25.8% -36.6% y/y	**GERMANY** **Industrial Production** **May (e) +10.0% -18.0% y/y** Apr. -17.9% -25.3% y/y **FRANCE** **Trade Deficit** **May** Apr. €5.0 bln **ITALY** **Retail Sales** **May (e) +15.0% -17.0% y/y** Apr. -10.5% -26.3% y/y		**GERMANY** **Trade Surplus** **May** Apr. €3.3 bln	**FRANCE** **Industrial Production** **May (e) +15.0% -24.5% y/y** Apr. -20.1% -34.2% y/y **Manufacturing Production** **May** Apr. -21.9% -37.1% y/y **ITALY** **Industrial Production** **May (e) +21.5% -30.7% y/y** Apr. -19.1% -42.5% y/y
U.K.	**Construction PMI** **June (e) 46.5** May 28.9	**Labour Costs** **Q1** Q4 +2.4% y/y		**RICS House Price Balance** **June (e) -25%** May -32%	
Other	**CHINA** **Foreign Reserves [D]** **June (e) $3.1 trln** May $3.1 trln	**AUSTRALIA** **RBA Monetary Policy Meeting**		**CHINA** **CPI PPI** **June (e) +2.5% y/y -3.2% y/y** May +2.4% y/y -3.7% y/y **Aggregate Yuan Financing [D]** **June (e) 3.1 trln** May 3.2 trln **New Yuan Loans [D]** **June (e) 1.8 trln** May 1.5 trln **M2 Money Supply [D]** **June (e) +11.1% y/y** May +11.1% y/y **Foreign Direct Investment [D]** **June** May +7.5% y/y	

[D] = date approximate

Upcoming Policy Meetings | Bank of England: Aug. 6, Sep. 17, Nov. 5 | European Central Bank: July 16, Sep. 10, Oct. 29

Canada

Monday July 6

10:30 am **BoC Business Outlook Survey and Survey of Consumer Expectations (Q2)**

BoC Buyback: 30-year sector

Tuesday July 7

10:00 am **Ivey Purchasing Managers Index (s.a.)**
June
May 39.1

10:30 am 3-, 6- & 12-month bill auction $12.0 bln (new cash -$0.8 bln)

BoC Buyback: Under 2-year sector

Wednesday July 8

8:15 am **Housing Starts**
June (e) **195,000 a.r. (+0.8%)**
May 193,453 a.r. (+16.2%)

Federal Economic and Fiscal Snapshot

Noon 3-year bond auction $5.0 bln

BoC Buyback: 2-year sector

Thursday July 9

Noon 10-year bond auction $5.0 bln

5-year bond auction announcement

BoC Buyback: 10-year sector

Friday July 10

8:30 am **Employment**
June (e) **+2.7% (+450,000)**
May +1.8% (+289,600)

8:30 am **Unemployment Rate**
June (e) **12.8%**
May 13.7%

8:30 am **Average Hourly Wages**
June (e) **+8.5% y/y**
May +10.5% y/y

BoC Buyback: 5-year sector

United States

Monday July 6

8:30 am **Real GDP by Industry (Q1)**

10:00 am **Non-manufacturing ISM (NMI)**
June (e) **50.0**
Consensus *50.0*
May 45.4

Fed speakers: San Francisco's Daly (2:00 pm); Richmond's Barkin (2:00 pm)

11:30 am 13- & 26-week bill auctions $105 bln

Tuesday July 7

10:00 am **Job Openings & Labor Turnover Survey (May)**

Fed speakers: Atlanta's Bostic (9:00 am), Governor Quarles (1:00 pm)

11:00 am 4- & 8-week bill auction announcements

11:30 am 119-day cash management bill auction $35 bln

11:30 am 42-day cash management bill auction $35 bln

1:00 pm 3-year note auction $46 bln

Wednesday July 8

7:00 am **MBA Mortgage Apps**
July 3
June 26 -1.8%

3:00 pm **Consumer Credit**
May (e) **-$15.0 bln** [C]
Apr. -$68.8 bln

Fed speaker: Atlanta's Bostic (12:15 pm)

1:00 pm 10[R]-year note auction $29 bln

Thursday July 9

8:30 am **Initial Claims**
July 4 (e) **1,370k (-57k)**
June 27 1,427k (-55k)

8:30 am **Continuing Claims**
June 27
June 20 19,290k (+59k)

10:00 am **Wholesale Inventories**
May F (e) **-1.2%** [C]
Apr. +0.2%

Fed speaker: Atlanta's Bostic (12:00 pm)

11:00 am 13-, 26- & 52-week bill auction announcements

1:00 pm 30[R]-year bond auction $19 bln

Friday July 10

8:30 am **PPI Final Demand**

June (e)	**+0.4%**	**-0.2% y/y**
Consensus	*+0.4%*	*-0.2% y/y*
May	+0.4%	-0.8% y/y

8:30 am **PPI Final Demand ex. F&E**

June (e)	**+0.1%**	**+0.4% y/y**
Consensus	*+0.1%*	*+0.5% y/y*
May	-0.1%	+0.3% y/y

[C] = consensus [D] = date approximate [R] = reopening

Upcoming Policy Meetings | Bank of Canada: July 15, Sep. 9, Oct. 28 | FOMC: July 28-29, Sep. 15-16, Nov. 4-5

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