Focus

Feature Article

Second Thoughts on the Second Wave

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Fall Time... Except for COVID

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Financial markets sagged broadly this week, as **September continues to live down to its surly reputation for stocks**. A bevy of concerns weighed on investors, from resurgent virus cases in many areas, fading prospects for a U.S. fiscal package, mounting concerns about post-election uncertainty in Washington, and even some weakness in European banks. The ugly combination sent the Euro Stoxx 50 skidding to a 5% setback, its worst outing since a similar drop in early June. Stateside, the correction in tech deepened, with the Nasdaq now down more than 11% from the records hit on September 2—which already seems like a long time ago. The pullback in tech has left the broader S&P 500 dancing right around correction terrain. The retreat in risk assets sent most major currencies notably lower against a revived U.S. dollar, while also dimming inflation expectations and carving into gold's earlier gains. The one market that mostly sat out the large moves this week was government bonds; although, even there, yields obeyed the laws of risk-off-gravity, with 10-year Treasuries and GoCs dipping 4 bps.

This week's slate of economic data provided little respite, partly because it was decidedly second-tier material. And, the real-time indicators generally suggested that the rebound is losing momentum in a meaningful way in many economies. In the U.S., the slightly more stale official data were generally on the positive side of the ledger, if not quite meeting earlier big high-side surprises. Housing remains a major area of pronounced strength, with new home sales—admittedly a wildly whippy series —vaulting above 1.1 million units for the first time since 2006 in August. The mixed durable goods report for the same month pointed to some upside risk for our Q3 GDP call of 25%, but we **continue to expect growth to chill deeply in Q4**. The early read on manufacturing surveys for September points to some further gains, but flattening jobless claims in recent weeks (at a still-lofty 870,000) and fading fiscal support point to modest growth in the final three months of the year. We remain comfortable with our call of just 2.5% annualized growth in Q4, a refreshingly "normal" pace of activity amid a depressingly abnormal time.

The economic menu was even lighter in Canada, with the **Throne Speech** dominating the headlines. Cutting through the reams of rhetoric, the major message was that Ottawa fully intends on using all the "fiscal firepower" it can muster to support the economy through the second wave. Channelling their inner Mario Draghi, the federal government pledged to do *"whatever it takes"* on that front. Whether that is a promise or a threat is in the eye of the beholder, but it was followed the next day with the announcement of an even more generous replacement than initially planned for CERB (which, frankly, doesn't look that different). In addition, the wage subsidy program (CEWS) will now run at least until deep into 2021. There are two major takeaways here: First, the already groaning **budget deficit** ($343 billion, or nearly 16% of GDP) looks set to grow even fatter. That's despite the fact that the underlying economy has done better than assumed in the July fiscal update (it was based on a 6.8% drop in GDP this year; the OECD now says -5.8%).

The second big takeaway from Ottawa this week is that—unlike the stalemate in the U.S.—**fiscal policy appears poised to continue fully backstopping the Canadian economy** in the year ahead. (This is all assuming that the Throne Speech passes the

confidence vote in Parliament, a seemingly safe assumption.) By itself, this would suggest that Canada's near-term growth prospects should be firmer than the U.S. as we proceed through the volatile period ahead. Barring a last-gasp miracle, it appears that the U.S. economy will be left to its own devices, with no new fiscal support at least until well after the election. And, even then, there are zero guarantees that anything meaningful can get done in the lame-duck session—especially if there is still wrangling over the election results. Still, there are **at least two factors that will likely keep Canadian growth from fully separating from U.S. trends**. First, there will be an inevitable drag on Canada's **exports** from slower U.S. spending, as well as a pull on some key commodity prices. Second, Canada is also now dealing with a clear upswing in **new virus cases**; while not yet in the same league as the summer levels seen in the U.S. on a per capita basis, they are high enough to prompt some moderate new restrictions.

On balance, we **still look for slightly firmer growth in Canada than the U.S. over the next few quarters, but not a major separation**. And, besides a heavier fiscal hand, the other factor at play here is that Canada is still playing catch-up for a deeper drop in the spring. Big picture, we still expect the Canadian economy to contract by roughly a percentage point more than the U.S. for all of 2020 (officially, -5.5% versus -4.5%). In very broad terms, about half of that difference is due to a more complete shutdown earlier this year, and half due to the extra hit from the deep drop in oil prices this year.

As light as this week's fare was on the economic front, next week will make up for it, with a high-calorie diet on deck. **The first real glimpse of how the North American economy fared in September will begin to roll in**, and the highlight will be the U.S. jobs report on Friday. The general consensus is that payroll growth will dip below 1 million, while the unemployment rate could dip slightly further after the heavy drop to 8.4% in August. Also late next week, we'll see the manufacturing ISM, which likely held up well, and an early read on auto sales for this month. The issue there is whether sales were able to build on their remarkably quick recovery to the 15 million unit level in the prior month.

Canada's jobs data isn't due until the following week, so the focus in the days ahead will be on the **monthly GDP** report. The flash estimate for July was a hearty 3.0% rise, which we believe will stick, but the big mystery will be the initial take on August. Strong gains in hours worked, a 1.1% rise in retail sales, and sizzling housing activity had us pencilling in a strong gain of around 1.5% for the month, which boosted our view on a very strong Q3 overall. However, this week brought a pair of soggy flash estimates for manufacturing sales (-2.0%) and wholesale trade (+0.1%), casting some serious shade on our estimate. The bigger picture for both economies is that after the initial heartening snap-back in activity in many sectors, the longer and much harder slog for still-affected industries is now setting in, and will bring the economic data back down to reality in the days and weeks ahead.

One of the curious sidebar comments in this week's Throne Speech was a pledge to **reduce inequality**, through—and not to put too fine a point on it—taxing the ultra-rich. This of course raises many, many questions. First, is it simply a nod to their presumed political dance partner in order to get the Speech passed? If it's more than that, where precisely is the line drawn to qualify as ultra-rich—i.e., starter for the Raptors, or

homeowner in Toronto/Vancouver? Third, what kind of tax (income, wealth?) and what scale? But finally, and probably most importantly, precisely why?

If the focus is on economic recovery, why are policymakers even pondering policies that could potentially dent consumer or business sentiment? More fundamentally, the government spent much of the post-speech period listing all the many reasons why this is a reasonable time to be running outsized deficits. They relentlessly pointed to Canada's relatively mild public sector debt levels versus the rest of the G7, as well as the 100-year lows in interest rates, and of course the pressing economic need for fiscal support. Well, yes, if you accept all of those talking points, then the staggeringly obvious rejoinder is... so why then is there any need to raise revenues at this point? That is, **why should new public sector spending take up all of this valuable fiscal space?**

America's Hot Housing Sector

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Some **U.S. housing market milestones** were reached this week. In August, **existing home sales** hit the six million mark for the first time since December 2006, while **new home sales** hit the one million mark for the first time since November of that year. Several factors are lifting total sales to their highest level in almost 14 years, and the pandemic has its fingerprints all over them. Total home sales plummeted more than 28% during the March-May interval owing to the lockdowns. In the three months since, sales have surged more than 52%, to well above their pre-pandemic trend line (this isn't a V-shaped recovery, it's a Z-shaped recovery). While part of this is simply the unleashing of pent-up demand, the underlying demand for homes has shifted up as well.

Demand is being prodded by **post-pandemic preferences for bigger abodes**, reflecting the work-from-home (WFH) phenomenon, and properties in less densely populated areas, those further away from urban centres and even suburban centres. Not only are these areas usually where larger homes are more affordable and single-family units more available, but WFH has downgraded commutability among desirable housing attributes. Demand is also being driven by record-low mortgage rates, the consequence of the Fed's policy response to the pandemic. Thirty-year tenors have been running under 3% (since mid-July) for the first time since Freddie Mac's weekly survey started 49 years ago.

The **increasing demand is hoovering up available supply**. Seasonally-adjusted existing homes for sale ran at record-low levels in July and August (as far back as 1982 for single-family units). Relative to sales, supply is now less than three months' worth, also a record low. This, in turn, is further stoking activity in the new home segment. The NAHB Housing Market Index hit a record high in September (this survey started 35 years ago). Homebuilders are anticipating higher sales, but their inventories are still being drawn down; new one-family homes for sale are at three-year lows. However, relative to sales, supply is now at a record-low 3.3 months' worth (data here go back to 1963). Residential construction is in for a good year.

The median existing home price increased 11.4% y/y in August, its first time in double digits in more than 6½ years. While this raised some eyebrows, this metric is distorted by changes in the types and locations of homes sold. The same holds for the median new home price: it decreased 4.3% y/y in August. Better-crafted home price metrics

such as the FHFA House Price Index (+6.4% y/y in July) and the S&P CoreLogic Case-Shiller Home Price Index (+4.3% y/y in June) **continue to run within their recent ranges**. While there are no sign of prices bubbling over, one wonders how long this housing heat can last.

Seismic events such as the pandemic can either speed up existing economic and social trends (think technology), slow down others (think globalization), be the catalyst for new ones (think WFH), or be the tipping-point for looming economic and social trends. We've all been anticipating the 'great migration', when millennials make the move from renting downtown to owning in the 'burbs, and perhaps the pandemic will prove to be its tipping point. The **current housing upswing could have longevity**.

How Much Fiscal Boost Did the U.S. Recovery Get?

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With markets fretting about congressional gridlock on additional stimulus measures and Fed Chair Powell seemingly camping out on Capitol Hill this week to warn lawmakers to keep the fiscal taps on, it's worth stepping back to assess **how much policy has already helped the economy**. Fortunately, the Congressional Budget Office has done all the dirty work of estimating the impact of the four relief bills that were passed in March and April. The two biggest bills, the **CARES Act** and **Paycheck Protection Program (PPP)**, provided loans to businesses (many of which turned into grants for small businesses that retained staff), a $600 weekly federal top-up of state unemployment insurance benefits, a $1,200 cheque to most adults and $500 for dependent children, increased funding to state and local governments, and a plethora of other supportive measures including for the health care system. Though subject to a wide band of uncertainty, the **four bills are estimated to lift real GDP by 4.7% in 2020** and 3.1% next year. Without this fiscal jolt, the economy could have contracted about twice as much as we expect for 2020 (-4.5%), which would have put this year in league with the 12.9% plunge of 1932, in the darkest days of the Great Depression.

Almost one quarter (1.1%) of the fiscal lift this year will come from beefed-up benefits to the unemployed. The PPP adds another 0.8% to GDP, mostly by limiting business insolvencies and permanent layoffs, while the rebate cheques to individuals chip in 0.6% and the extra funds for state and local governments contribute 0.5%.

Of course, there is a **cost to this fiscal largesse**. By adding almost $3 trillion to the national debt, the legislation is expected to weigh moderately on longer-term growth by raising borrowing costs and crowding out investment (though there is no evidence of such, so far). The CBO also warns that the larger budget deficit raises the risk of a fiscal crisis if investors lose confidence in the ability of the government to manage its debt.

Debt sustainability isn't a pressing concern today. No one questions the use of too much water to put out a fire. The more urgent issue is that the hoses could run dry before the pandemic embers cool down. And the resulting weaker economy would then burn an even deeper hole in government finances.

The Intelligent Investors

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Equity markets have stalled after a tremendous run through the early summer took many indices back to record highs. Now, the S&P 500 has gone quiet since mid-June. What gives? The stock market might be smarter than you think.

Consolidation: The S&P 500 surged 60% in the span of just five months from the March lows. Using weekly data, we've never seen a rally that strong, over that time period, in the post-war era. Sometimes the simplest answer is the correct one—the market just needs a breather.

Tech check: While the S&P 500 broke pre-COVID levels before pulling back in recent weeks, the tech-heavy Nasdaq blew through those levels and remains almost 10% above February's high, despite some heavy down days recently. The market has clearly moved into these names as a source of growth and strong balance sheets at a time when many other sectors are facing a tougher outlook. But, tech and communication services have been the worst performers on the S&P 500 since early-September as some of that momentum has been let out.

Valuation constraint: Digging a bit deeper, the forward p/e ratio on the S&P 500 now sits just under 22, based on blended forward-year earnings compiled by Bloomberg, and we haven't seen readings that high in almost 20 years. But, earnings are clearly depressed at the moment, and it's debatable if the market is even trading based on near-term earnings estimates anyway. If we use earnings two-years forward, the market is trading right in-line with where it did pre-COVID (in the 16-to-17 range). The question then becomes one of how temporary the current earnings hit really is. If the forecast plays out roughly as currently assumed, then stocks look to be consolidating right about where they should be.

Eye on COVID: With cases picking up across much of the developed world, there is some concern mounting that the earnings outlook will be tested again. One interesting observation is that, as much as many pundits questioned the very aggressive rally in stocks early on, much of the economic data have subsequently backed it up—especially in areas like consumer spending, housing, durable orders and trade. We know the market is always trading in a world six-to-twelve months forward, and it turns out that it was almost perfectly accurate through the spring and summer. What does it see now? Probably some choppier growth ahead as targeted lockdowns loom, but not the wide-scale shutting of the economy that we saw in the spring. As Doug and Michael note in this week's *Feature*, that is probably the correct bet.

Policy: Aggressive monetary policy was a big factor that helped spur the recovery in stocks. And, while policy will remain highly accommodative, what more can the Fed really do at this point? If the market has already priced in open-ended QE and low-forever interest rates, any incremental gains from monetary policy will become much smaller. On the fiscal side, developments in Washington continue to cast support/stimulus in doubt, and the election rhetoric (mainly about an inconclusive or contested result) opens up more uncertainty.

The Bottom Line: As surprising as it might have been to many, the equity market has more or less done what it should have done so far through the pandemic. The

backdrop should remain supportive, but the next leg of the recovery is going to be tougher for the economy, and that could be just what the equity market is telling us.

Harsh Winter Ahead

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Images of cold, harsh wintery conditions and vast empty fields were conjured up this week when listening to British officials describe the challenges that lay before them. "*The harder yards are ahead*", warned **Governor Bailey**, while **Chancellor Sunak** tabled plans to help workers get through the "*difficult winter months*". With 12% of private sector workers still on furlough, and a second wave of infections sweeping across the country, the Chancellor had to shelve his usual autumn budget and, instead, introduced new measures to help support the economy and workers. The program that will have the biggest impact is the **Job Support Scheme**, which will take over once the Job Retention Scheme wraps up on October 31. The new job program will have a 6-month lifespan, helping cover as much as 77% of workers' salaries until the spring, which is less than its predecessor. But, as Rishi Sunak admitted, "*I can't save every business, I cannot save every job.*"

Is all of this necessary? Isn't Europe bouncing back faster than policymakers and government officials expected? Yes it did, but the **recovery is clearly losing steam**. Much of the rebound was a result of pent-up demand from the spring lockdowns. Workers were displaced but governments rolled out generous programs to help cushion the blow from being temporarily laid off. Then, as activity started to normalize and schools reopened, the second wave began. Various countries began to restrict some activities in higher-risk areas. In the **U.K.**, restaurants and pubs must now close up shop by 10 pm, office workers are encouraged to work from home, social gatherings are limited to six, and plans for a controlled return to sports stadiums are on ice. In **France**, restaurants and bars in various cities including Paris must close by 10 pm, while some in Marseille have been shut down completely. In **Spain**, local officials are limiting the mobility of 850,000 people in Madrid.

The return of restrictions and general fear over the virus is curbing the recovery. In September, manufacturing and services activity in the U.K. slipped to a 2-month low. In the Euro Area, while the manufacturing PMI hit a 2-year high, the services PMI fell to its lowest since May. Services activity in Germany and France fell to their lowest levels since the early summer. Even though business confidence in the two largest Euro Area countries climbed to the highest levels since February, upside is limited given the new lockdowns.

Bundle up.

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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 ▪ Throne Speech promises full use of fiscal firepower; government will do "*whatever it takes*"	**SEPH Employment** +739,705, or 5.1% (July) **New Housing Price Index** +0.5% (Aug.) **Wholesale Trade** +0.1% (Aug.)—but slowing... StatsCan flash estimate	**Manufacturing Sales** -2.0% (Aug.)—StatsCan flash estimate **Ottawa's budget deficit** balloons to $148.6 bln (Apr.-to-July)
United States ▪ House passes bill to keep government funded until December 11... Senate still needs to ratify ▪ Fed Chair Powell... despite improvement in economy, the path ahead is "*highly uncertain*"	**Existing Home Sales** +2.4% to 14-year high 6.00 mln a.r. (Aug.) **New Home Sales** +4.8% to 1,011k a.r. (Aug.) **Household Net Worth** jumped to a record $119 trln (Q2) **Continuing Claims** -167k to 12,580k (Sep. 12 week) **Core Durable Goods** +1.8% (Aug.) **Chicago Fed National Activity Index** +0.79 (Aug.)	**Initial Claims** +4k to 870k (Sep. 19 week)
Japan ▪ Cabinet Office monthly report still cites "severe" conditions in the economy	**Manufacturing PMI** +0.1 pts to 47.3; **Services PMI** +0.6 pts to 45.6 (Sep. P) **All-Industry Activity Index** +1.3% (July)	**Department Store Sales** -22.0% y/y (Aug.)
Europe ▪ Restrictions tighten as virus cases climb ▪ U.K. government rolls out more support programs ▪ BoE Governor Bailey plays down possible negative interest rate usage	**Euro Area—Manufacturing PMI** +2.0 pts to 53.7 (Sep. P) **Euro Area—Consumer Confidence** +0.8 pts to -13.9 (Sep.) **Euro Area—Private Sector Credit Growth** +4.7% y/y (Aug.) **Germany—ifo Business Survey** +0.9 pts to 93.4 (Sep.)—highest since February **France—Business Confidence** +2 pts to 92 (Sep.)—highest since February **Italy—Consumer Confidence** +2.4 pts to 103.4 (Sep.) **U.K.—Rightmove House Prices** +5.0% y/y (Sep.) **U.K.—GfK Consumer Confidence** +2 pts to -25 (Sep.)	**Euro Area—Services PMI** -2.9 pts to 47.6 (Sep. P) **Germany—Gfk Consumer Confidence** +0.1 pts to -1.6 (Oct.)—very disappointing **U.K.—Manufacturing PMI** -0.9 pts to 54.3; **Services PMI** -3.7 pts to 55.1 (Sep. P)
Other ▪ RBNZ on hold; Mexico cuts rates 25 bps; Turkey raises rates 200 bps		**Australia—Retail Sales Volumes** -4.2% (Aug. P)

Second Thoughts on the Second Wave

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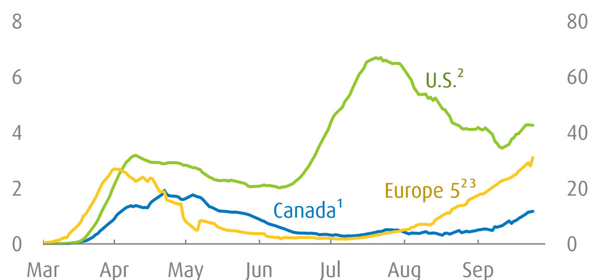
A resurgence in COVID cases in Canada and many European nations, a seeming echo of the U.S. summer experience, is unnerving investors and unsettling the economic outlook. In addition, a recent slide in new cases in the U.S. looks to be stalling (*Chart 1*). For at least some jurisdictions, the long-anticipated and much-dreaded second wave does indeed appear to be upon us. **What does this rise in new cases, along with mounting U.S. election uncertainty, imply for the economic outlook now?**

We don't believe the sudden rise in virus caseloads in many economies significantly changes the fundamental forecast... yet. There are at least two major reasons: **First**, the public health policy response will likely be more targeted or surgical this time, compared with the broad-based, economy-crushing spring shutdowns. This is because lessons were learned in how to slow the virus through other steps (e.g., masks), and policymakers do not want (and, in some cases, cannot afford) to fully shut the economy down again. Moreover, the sectors that would be most affected by increased distancing measures are already struggling heavily, while much of the rest of the economy has largely learned to deal with restrictive conditions. **Second**, hospitalization and mortality rates are still well below spring levels (in part because the demographics of those falling ill are much younger now), so immediate concerns about overwhelming the health system seem overdone... so far.

Chart 1
COVID Case Upswing

2020 (000s : 7-day m.a. : as of September 24, 2020)
New Confirmed COVID-19 Cases



Note: scales roughly equilibriate lines on a per capita basis; [1] (lhs); [2] (rhs); [3] France, Germany, Italy, Spain, U.K.
Sources: BMO Economics, Haver Analytics, John Hopkins University

Clearly, there is a real risk that caseloads could accelerate to the point where public health officials in some areas don't have many good options. But, here the U.S. experience this summer may serve as an important lesson to other economies that are now in the early stages of a big upswing in cases. There, the case load sprinted in the summer, but with basic measures (masks, social distancing, and some rollbacks in re-openings), cases were eventually capped and came back down, with no major further economic damage in the ensuing weeks. From a health perspective, it may not be the best example to follow, but the U.S. experience was telling from an economic standpoint—the recovery did manage to soldier on even with a high case count, and reduced fiscal support. Finally, there is also still the entirely realistic chance of a positive surprise on the vaccine front—we have been cautious in our assumptions here —resulting in a better-than-expected economic outcome in 2021.

One key issue surrounding the potential for a true second wave is that **fiscal and monetary policy is less well-placed to support the economy if more severe restrictions are required**. A prime example is the U.S. fiscal front, where downside economic risks are escalating owing to the trifecta of ended or soon-ending federal income-support programs, pressure among state and local governments to balance

their budgets, and the inability of Congress to pass another economic support package. Part of this inability is tied to the fast approaching election, the uncertain outcome of which is also imparting downside risk.

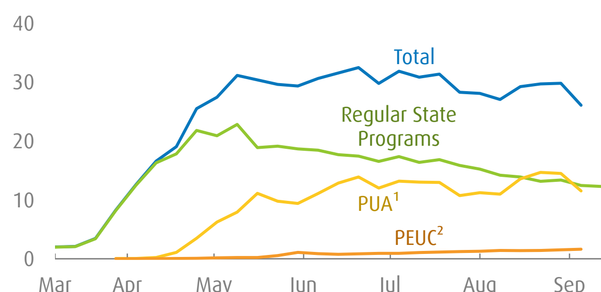
Detail on U.S. Federal Fiscal Support

There are three major U.S. federal income support programs for the unemployed. First, the Pandemic Unemployment Assistance (PUA) benefit is paid to workers not normally eligible for regular state benefits such as self-employed and gig workers. Second, the Pandemic Emergency Unemployment Compensation (PEUC) benefit is paid to workers normally eligible but whose regular state unemployment insurance (UI) benefits have run out. Both the PUA and PEUC programs are scheduled to expire at year-end, unless Congress extends them. Third, there is the top-up on all federal- and state-funded UI payments, which was already reduced last month, because Congress didn't extend it.

The CARES Act's $600 weekly top-up stopped being paid the period ending August 1. It was replaced by the Trump Administration's Lost Wages Assistance (LWA) program, with a FEMA-funded payment of $300. The LWA also required a minimum pre-top-up UI payment of $100, which excluded some 3% to 6% of recipients (according to estimates). Also, states were requested to fund an additional $100 top-up, but only three states signed on. The program is scheduled to run until December 6 or until FEMA's Disaster Reserve Fund (DRF) falls to $25 billion. As at August 31, the fund was $52.8 billon, with September top-ups and other DRP outlays (reflecting past natural disasters) estimated at more than $37 billion. As such, these top-ups are unlikely to continue past month end.

Chart 2
Joblessness Proving Stubborn

United States — 2020 (mlns of persons : n.s.a.)
Unemployment Insurance Recipients



[1] Pandemic Unemployment Assistance; [2] Pandemic Emergency Unemployment Compensation Sources: BMO Economics, Haver Analytics

The number of Americans receiving jobless benefits has flattened recently, as rising PUA and PEUC recipients have offset falling regular state UI recipients (Chart 2). To roughly gauge the hit to incomes from the first top-up reduction, the total number receiving jobless benefits averaged 28.9 million during August, with 1.3 million seeing their $600 payment drop to zero (assuming a midrange 4½% didn't qualify for LWA) and the remaining 27.6 million dropping to $300. This results in a $9.1 billion reduction in total weekly payments, or over $39 billion for the month and $471 billion at an annual rate. This is a 2.4% monthly hit to personal income (other things equal), but with the net spending impact dampened by August's strong job growth and a likely lower personal saving rate.

The second top-up reduction, to be felt in October, will likely result in a smaller hit to incomes given lower numbers receiving jobless benefits and interim income growth. However, October job growth will probably be slower than August's with the personal saving rate potentially not falling as much, providing less of a dampening impact on

net spending. Indeed, this could become more pronounced by January even though the direct hit to incomes from the end of PUA and PEUC benefits will likely be less than either of the two hits from the top-up reductions.

PUA and PEUC payments are set at regular state UI payment levels. The latter averaged $378 per person, across all states, at the end of last year (according to the Department of Labor). Currently (four-week average ending September 5), there are 13.5 million receiving PUA benefits and 1.5 million receiving PEUC payments. At current recipient and income levels, these programs ending would result in a $5.7 billion reduction in total weekly payments, or almost $25 billion for the month and $296 billion at an annual rate. This 1.5% monthly hit to personal income would presumably be smaller by January given lower recipients and interim income growth.

The Paycheck Protection Program (PPP) closed on August 8, at which time the SBA had disbursed $525 billion of the $659 billion Congress had provided for the program (the undisbursed $134 billion goes back into Treasury's coffers). The PPP provides forgivable loans to small- and medium-sized businesses that maintain their payrolls at prescribed levels. It's unclear whether these funds would have been used if the program had been extended (for a second time). But with many small businesses likely to continue struggling, particularly those in the 'in-person' services segment, additional support will probably be required to prevent many of these firms from going out of business.

Fiscal consolidation at the state and local government level is forming another economic headwind, as these jurisdictions attempt to balance their budgets amid a recession-related reduction in revenue and spending boosted by the economic downturn and measures to combat the pandemic. Earlier this year, the National Association of Governors made a bipartisan appeal for an additional $500 billion in federal support, with the National Council of Mayors also making an appeal for $250 billion. Without additional support from the federal government, economic-growth sapping spending cuts (e.g., cuts to state and local government payrolls and infrastructure outlays) and tax/fee hikes loom.

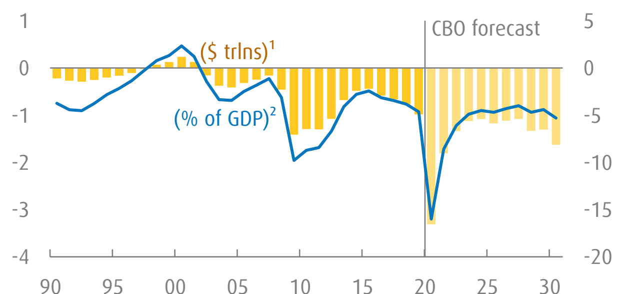
Indeed, Democrats and Republicans disagree most on additional support for state and local governments, along with the fact that the deficit is already massive (a post-war high as a share of GDP) and should act as a constraint on the size of any new stimulus package (*Chart 3*). A compromise deal in the mid-$1 trillion to low-$2 trillion range was looking doable several weeks ago, but the odds of getting this done before the election, or done at all, have since dropped meaningfully. In addition to heightened partisanship heading into the election, the push to get a new judge on the Supreme Court to replace Justice Ginsburg before the election has shifted the focus away from another stimulus package. And, after the election, it's unclear whether the lame-duck Congress or incumbent/out-going Administration will have any more success at getting a stimulus bill passed. It should also be noted that an election outcome that is

Chart 3

Deficit Already Running Large

United States

Budget Balance



[1] (lhs); [2] (rhs)

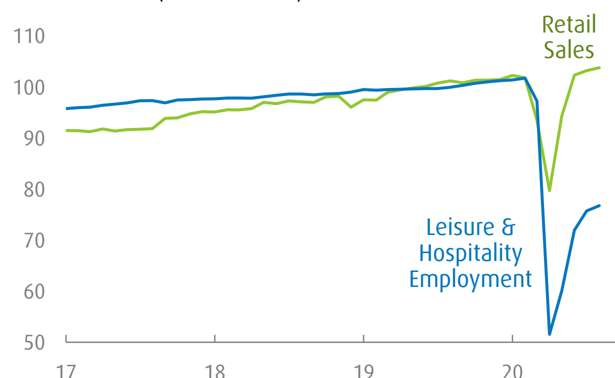
Sources: BMO Economics, Haver Analytics, Congressional Budget Office (CBO)

not definitive or that gets dragged into the courts would further lessen the likelihood of a stimulus package and prod additional downside economic risk arising from any associated financial market weakness and volatility. Fed Chair Powell has consistently implored Congress to get its act together because *"more fiscal support is likely to be needed"* for the persistently unemployed, struggling small businesses and cash-strapped state and local governments. At risk is the health of the economic recovery.

Even Canada has a soupçon of fiscal policy uncertainty. This week's Throne Speech still has to pass a confidence vote in Parliament with a minority government. Assuming an election isn't triggered, the main message from the Speech was that the government will *"do whatever it takes"* to support the economy through the second wave. Thus, while any extra U.S. fiscal stimulus will need to await at least until after the November election, Canadian government spending looks to continue rolling in at full bore, even as the CERB winds down and is replaced by the expanded EI and a suite of other programs.

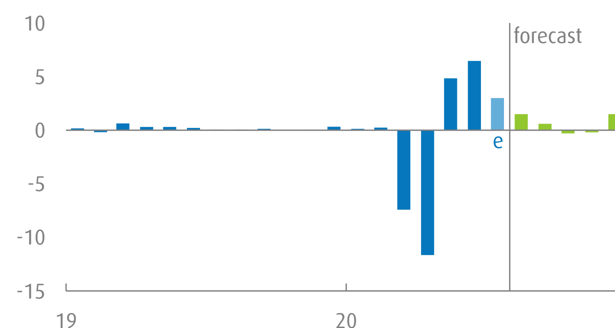
Meantime, the underlying economy has performed better than widely expected. For both Canada and the U.S., the recovery has been at the upper end of scenario ranges foreseen by the consensus at the depths in April. That's especially the case for consumer spending and housing activity in both economies. There is little mystery on what's going on here, as massive government support has lifted incomes above pre-pandemic trends, bolstering savings and actually strengthening household finances. However, there is quite clearly a two-track recovery at play—the so-called K-shape—with some sectors snapping back quickly, and others still bouncing along the bottom (*Chart 4*). Moreover, with virus cases rising in Canada and fiscal support fading in the U.S., the risk is now that the rebound in even the strong sectors could cool, or worse, stall.

Chart 4
Recovery: Similar Shape, Separate Tracks



Sources: BMO Economics, Haver Analytics

Chart 5
The Shape of Things to Come



e = Statistics Canada estimate *Sources: BMO Economics, Haver Analytics*

So, where does this all leave us as we head into the U.S. election, and its aftermath? Even before the recent rise in cases, we have been assuming that, after the initial burst in activity as economies re-opened, growth will cool markedly. At the very least, **we will see some real moderation in coming months, with even a small pullback for a spell in some economies possible, before a more complete recovery takes hold** (*Chart 5*). However, we believe that even with stiffer headwinds ahead, the North American economy will avoid a full-on double dip (or W shape), but the road is about to get much bumpier.

Economic Forecast Summary for September 25, 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	-38.7	48.0	3.9	7.0	5.3	4.0	3.2	1.7	-5.5	6.0
Consumer Price Index	(y/y % chng)	1.8	0.0	0.4	0.3	0.6	1.9	1.6	1.7	1.9	0.6	1.4
Unemployment Rate	(percent)	6.3	13.0	10.2	8.9	8.4	8.1	7.9	7.5	5.7	9.6	8.0
Housing Starts	(000s : a.r.)	209	191	236	205	210	206	202	202	209	210	205
Current Account Balance	($blns : a.r.)	-52.9	-34.5	-31.5	-31.3	-33.2	-33.7	-33.8	-35.3	-47.0	-37.5	-34.0
Interest Rates		(average for the quarter : %)										
Overnight Rate		1.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	1.75	0.50	0.25
3-month Treasury Bill		1.29	0.22	0.15	0.15	0.15	0.15	0.15	0.15	1.65	0.45	0.15
10-year Bond		1.20	0.59	0.55	0.60	0.70	0.75	0.80	0.90	1.59	0.75	0.80
Canada-U.S. Interest Rate Spreads		(average for the quarter : bps)										
90-day		16	8	5	3	3	3	3	3	-45	8	3
10-year		-18	-10	-10	-12	-11	-11	-10	-10	-56	-12	-10
UNITED STATES												
Real GDP	(q/q % chng : a.r.)	-5.0	-31.7	25.0	2.5	5.8	5.7	4.1	3.2	2.2	-4.5	4.0
Consumer Price Index	(y/y % chng)	2.1	0.4	1.2	1.2	1.4	2.6	1.9	1.9	1.8	1.2	1.9
Unemployment Rate	(percent)	3.8	13.0	9.0	8.2	7.6	7.0	6.4	6.0	3.7	8.5	6.8
Housing Starts	(mlns : a.r.)	1.48	1.08	1.43	1.33	1.30	1.31	1.31	1.32	1.30	1.33	1.31
Current Account Balance	($blns : a.r.)	-446	-682	-654	-659	-677	-685	-695	-703	-480	-610	-690
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	0.10	0.10	0.10	0.10	0.10	0.10	2.10	0.40	0.10
10-year Note		1.38	0.69	0.65	0.75	0.80	0.85	0.90	1.00	2.14	0.85	0.90
EXCHANGE RATES		(average for the quarter)										
US¢/C$		74.4	72.2	75.1	75.8	75.9	76.2	76.5	76.8	75.4	74.4	76.4
C$/US$		1.34	1.39	1.33	1.32	1.32	1.31	1.31	1.30	1.33	1.35	1.31
¥/US$		109	108	106	105	105	106	106	107	109	107	106
US$/Euro		1.10	1.10	1.17	1.20	1.20	1.21	1.21	1.22	1.12	1.14	1.21
US$/£		1.28	1.24	1.29	1.29	1.30	1.31	1.32	1.33	1.28	1.28	1.31

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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Monthly Real GDP

Wednesday, 8:30 am

July (e)	**+3.0%**
June	+6.5%

The economy continued to march forward in July, though at a slower pace as the initial sharp rebound naturally decelerates. **Manufacturing** and **wholesale** activity saw another month of strong gains, but **retail** was up only modestly, with the latter already above pre-pandemic levels. **Home sales** surged to record levels as mortgage rates moved to new lows and pent-up demand continues to be unleashed. Meantime, **hotels/restaurants**, **arts/entertainment** and **transportation** (air traffic remains extremely low with borders shut) remain at weak levels, seeing only modest improvements at best. Indeed, those sectors are in for a very lengthy recovery. Putting it all together, we're looking for **GDP** to rise 3%, in line with StatCan's flash estimate. While it's only the first month of the quarter, our call, plus the momentum from Q2, would put Q3 GDP on pace for about 48% annualized growth.

United States

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Personal Spending and Income

Thursday, 8:30 am

	Personal Spending	Personal Income
Aug. (e)	**+0.7%**	**-2.0%**
Consensus	*+0.7%*	*-2.1%*
July	+1.9%	+0.4%

	Core PCE Price Index	
Aug. (e)	**+0.3%**	**+1.5% y/y**
Consensus	*+0.3%*	*+1.4% y/y*
July	+0.3%	+1.3% y/y

Personal spending is expected to rise 0.7% in August after leaping 1.9% in July. While "core" retail sales were on the light side last month, sales at auto dealers and restaurants sped up. Spending volumes should rise 0.3%, implying some upside to our Q3 estimate (29% a.r.) for consumer spending after Q2's 34% contraction. Despite a big gain in work hours, **personal income** likely retreated 2.0% due to the scaling back of supplemental UI benefits. **Core prices** look to post another outsized 0.3% advance, taking the yearly rate up two notches to 1.5%. That's well above April's lockdown low of 0.9% amid less discounting, but still below February's 1.9% high due to economic slack.

ISM Manufacturing PMI

Thursday, 10:00 am

Sep. (e)	**55.0**
Consensus	*56.0*
Aug.	56.0

U.S. factories are enjoying a peppy pickup, but the pace of activity likely moderated in September. After spiking to near two-year highs in August, the **manufacturing index** could slip to 55.0, indicating a still-solid rate of expansion. The index has come a long way from April's 11-year low of 41.5. Production has been supported by rising consumer demand, a rebound in goods exports, and the need to replenish plunging inventories. However, sluggish business investment and virus concerns are holding it back. New orders hit a 16-year high in August, and a further advance would indicate decent momentum heading into the fall.

Key for Next Week

Nonfarm Payrolls

Friday, 8:30 am

Sep. (e)	**+1,100,000**	
Consensus	*+900,000*	
Aug.	+1,371,000	

Unemployment Rate

Sep. (e)	**8.2%**	
Consensus	*8.2%*	
Aug.	8.4%	

Average Hourly Earnings

Sep. (e)	**+0.1%**	**+4.8% y/y**
Consensus	*+0.2%*	*+4.9% y/y*
Aug.	+0.4%	+4.7% y/y

We expect a slower 1.1 million increase in September **payrolls** after the prior month's gain was inflated by the temporary hiring of census workers. This should unwind just over half of the 22 million layoffs during the shutdowns. The **unemployment rate** is expected to slip modestly to 8.2% after plunging 1.8 ppts in August amid a giant (3.8 million) leap in household survey jobs. The jobless rate has fallen sharply from April's postwar peak of 14.7%, but remains well above February's half-century low of 3.5%. Keep an eye on the number of **permanent unemployed**, which has risen by 2.1 million since February to 3.4 million, accounting for 25% of the unemployed versus 22% earlier this year. **Average hourly earnings** could rise slightly, lifting the yearly rate to 4.8%, a figure still inflated by the concentration of layoffs among lower-paid workers.

Financial Markets Update for September 25, 2020

		Sep 25 [1]	Sep 18	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	0.15	0.15	0	0	-151
	United States	0.09	0.08	1	0	-145
	Japan	-0.14	-0.12	-2	-4	-3
	Eurozone	-0.50	-0.50	1	-2	-12
	United Kingdom	0.06	0.05	1	-1	-73
	Australia	0.10	0.09	1	1	-81
2-Year Bonds	Canada	0.26	0.26	0	-2	-144
	United States	0.13	0.14	-1	0	-144
10-Year Bonds	Canada	0.54	0.58	-4	-9	-116
	United States	0.66	0.70	-4	-7	-126
	Japan	0.01	0.01	0	-4	3
	Germany	-0.53	-0.49	-4	-12	-34
	United Kingdom	0.19	0.18	1	-12	-63
	Australia	0.80	0.89	-9	-22	-57
Risk Indicators	VIX	28.5	25.8	2.7 pts	5.6 pts	14.7 pts
	TED Spread	13	14	-2	-2	-24
	Inv. Grade CDS Spread [2]	59	71	-12	-8	14
	High Yield CDS Spread [2]	391	348	43	21	111
					(percent change)	
Currencies	US¢/C$	74.63	75.73	-1.5	-2.2	-3.1
	C$/US$	1.340	1.320	—	—	—
	¥/US$	105.65	104.57	1.0	0.3	-2.7
	US$/€	1.1631	1.1840	-1.8	-2.3	3.7
	US$/£	1.271	1.292	-1.6	-4.8	-4.1
	US¢/A$	70.26	72.89	-3.6	-4.6	0.1
Commodities	CRB Futures Index	147.75	151.54	-2.5	-3.7	-20.5
	Oil (generic contract)	39.87	41.32	-3.5	-7.2	-34.7
	Natural Gas (generic contract)	2.22	2.05	8.5	-16.4	1.5
	Gold (spot price)	1,863.88	1,950.86	-4.5	-5.1	22.8
Equities	S&P/TSX Composite	15,907	16,199	-1.8	-4.8	-6.8
	S&P 500	3,251	3,319	-2.1	-7.3	0.6
	Nasdaq	10,766	10,793	-0.3	-7.9	20.0
	Dow Jones Industrial	26,881	27,657	-2.8	-6.2	-5.8
	Nikkei	23,205	23,360	-0.7	1.4	-1.9
	Frankfurt DAX	12,453	13,116	-5.1	-4.4	-6.0
	London FT100	5,827	6,007	-3.0	-2.3	-22.7
	France CAC40	4,720	4,978	-5.2	-5.7	-21.0
	S&P ASX 200	5,965	5,865	1.7	-1.8	-10.8

[1] = as of 10:40 am *[2] = One day delay*

Global Calendar — September 28–October 2

	Monday September 28	Tuesday September 29	Wednesday September 30	Thursday October 1	Friday October 2
Japan		**BoJ Summary of Opinions**	**Retail Sales** **Aug. (e) +2.0% -3.2% y/y** July -3.4% -2.9% y/y **Industrial Production** **Aug. P (e) +1.5% -13.4% y/y** July +8.7% -15.5% y/y **Machine Tool Orders** **Aug. F (e) -23.3% y/y** July -31.1% y/y	**Tankan Large Mfg. Index** **Q3 (e) -23** Q2 -34 **Manufacturing PMI** **Sep. F (e) 47.3** Aug. 47.2	**Jobless Rate** **Aug. (e) 3.0%** July 2.9% **Consumer Confidence** **Sep. (e) 31.4** Aug. 29.3
Euro Area		**EURO AREA** **Economic Confidence** **Sep. (e) 89.0** Aug. 87.7 **Consumer Confidence** **Sep. F (e) -13.9** Aug. -14.7 **GERMANY** **Consumer Price Index** **Sep. P (e) -0.1% -0.1% y/y** Aug. -0.2% -0.1% y/y **FRANCE** **Consumer Confidence** **Sep. (e) 93** Aug. 94	**GERMANY** **Unemploy. Jobless Rate** **Sep. (e) -7,000 6.4%** Aug. -9,000 6.4% **Retail Sales** **Aug. (e) +0.5% +4.4% y/y** July -0.2% +5.0% y/y **FRANCE** **Consumer Price Index** **Sep. P (e) -0.4% +0.3% y/y** Aug. -0.1% +0.2% y/y **Consumer Spending** **Aug. (e) -0.2% +0.4% y/y** July +0.5% +0.6% y/y **ITALY** **Consumer Price Index** **Sep. P (e) +1.5% -0.4% y/y** Aug. -1.3% -0.5% y/y	**EURO AREA** **Manufacturing PMI** **Sep. F (e) 53.7** Aug. 51.7 **Jobless Rate** **Aug. (e) 8.0%** July 7.9% **ITALY** **Jobless Rate** **Aug. P (e) 10.1%** July 9.7%	**EURO AREA** **Consumer Price Index** **Sep. (e) +0.3% -0.2% y/y** Aug. -0.4% -0.2% y/y **Core CPI** **Sep. (e) +0.5% y/y** Aug. +0.4% y/y
U.K.	**EU/U.K. joint meeting**		**Real GDP** **Q2 F (e) -20.4% -21.7% y/y** Q2 P -20.4% -21.7% y/y Q1 -2.2% -1.7% y/y	**Manufacturing PMI** **Sep. F (e) 54.3** Aug. 55.2	
Other			**CHINA** **Mfg PMI Non-mfg** **Sep. (e) 51.3 54.6** Aug. 51.0 55.2 **Caixin Manufacturing PMI** **Sep. (e) 53.1** Aug. 53.1 **AUSTRALIA** **Building Approvals** **Aug.** July +12.0%	**RBI Monetary Policy Meeting**	**AUSTRALIA** **Retail Sales** **Aug. (e) -4.2%** July +3.2%

D = date approximate

Upcoming Policy Meetings | Bank of England: Nov. 5, Dec. 17, Feb. 4 | European Central Bank: Oct. 29, Dec. 10, Jan. 21

Canada

Monday September 28
- BoC Buyback: 30-year sector

Tuesday September 29
- **8:30 am** Industrial Product Price Index / Raw Materials Price Index
  - **Aug. (e)** +0.1% / +1.0%
  - July +0.7% / +3.0%
- 10:30 am 3-, 6- & 12-month bill auction $10.0 bln (new cash -$7.0 bln)
- BoC Buyback: Under 2-year sector

Wednesday September 30
- **8:30 am** Monthly Real GDP
  - **July (e)** +3.0%
  - June +6.5%
- **Newfoundland & Labrador Budget**
- Noon 2-year bond auction $6.0 bln
- BoC Buyback: 2-year sector

Thursday October 1
- **8:30 am** Building Permits
  - **Aug. (e)** +5.0%
  - July -3.0%
- **9:30 am** Markit Manufacturing PMI
  - **Sep.**
  - Aug. 55.1
- **Auto Sales**[D]
  - **Sep.**
  - Aug. -8.9% y/y
- Noon 10-year bond auction $5.0 bln
- 2- & 5-year auction announcements
- BoC Buyback: 10-year sector

Friday October 2
- BoC Buyback: 5-year sector

United States

Monday September 28
- **10:30 am** Dallas Fed Mfg. Activity
  - **Sep. (e)** 10.0[C]
  - Aug. 8.0
- Fed Speaker: Cleveland's Mester (2:00 pm)
- 11:30 am 13- & 26-week bill auctions $105 bln

Tuesday September 29
- **8:30 am** Goods Trade Deficit
  - **Aug. A (e)** $81.8 bln[C]
  - July $80.1 bln
- **8:30 am** Wholesale and Retail Inventories (Aug. A)
- **9:00 am** S&P Case-Shiller Home Price Index (20 city)
  - **July (e)** +0.4% / +3.8% y/y
  - *Consensus* *+0.2%* / *+3.6% y/y*
  - June unch. / +3.5% y/y
- **10:00 am** Conference Board Consumer Confidence Index
  - **Sep. (e)** 90.0[C]
  - Aug. 84.8
- **9:00 pm First Presidential Debate at Case Western Reserve University in Cleveland, Ohio**
- Fed Speakers: New York's Williams (8:25 am, 9:15 am, 1:00 pm), Philadelphia's Harker (9:30 am), Vice Chair Clarida (11:40 am), Governor Quarles (1:00 pm, 3:00 pm)
- 11:00 am 4- & 8-week bill auction announcements
- 11:30 am 119-day CMB $30 bln
- 11:30 am 42-day CMB $30 bln

Wednesday September 30
- **7:00 am** MBA Mortgage Apps
  - **Sep. 25**
  - Sep. 18 +6.8%
- **8:15 am** ADP National Employment Report
  - **Sep. (e)** +800,000
  - *Consensus* *+650,000*
  - Aug. +428,000
- **8:30 am** Real GDP / GDP Deflator
  - **Q2 F (e)** -31.6% a.r. / -2.0% a.r.
  - *Consensus* *-31.7% a.r.* / *-2.0% a.r.*
  - Q2 P -31.6% a.r. / -2.0% a.r.
  - Q1 -5.0% a.r. / +1.4% a.r.
- **8:30 am** Pre-Tax Corporate Profits
  - **Q2 F (e)** -20.1% y/y
  - Q2 P -20.1% y/y
  - Q1 -6.7% y/y
- **8:30 am** Real GDP by Industry (Q2)
- **9:45 am** Chicago PMI
  - **Sep. (e)** 52.0[C]
  - Aug. 51.2
- **10:00 am** Pending Home Sales
  - **Aug. (e)** +2.0%
  - *Consensus* *+3.0%*
  - July +5.9%
- **U.S. Congress must extend funding before midnight to avoid partial shutdown**
- Fed Speakers: Minneapolis' Kashkari (11:00 am), Governor Bowman (1:40 pm), Dallas' Kaplan (6:00 pm)

Thursday October 1
- **7:30 am** Challenger Layoff Report
  - **Sep.**
  - Aug. +116.5% y/y
- **8:30 am** Initial Claims
  - **Sep. 26 (e)** 850k (-20k)[C]
  - Sep. 19 870k (+4k)
- **8:30 am** Continuing Claims
  - **Sep. 19**
  - Sep. 12 12,580k (-167k)
- **8:30 am** Personal Spending / Personal Income
  - **Aug. (e)** +0.7% / -2.0%
  - *Consensus* *+0.7%* / *-2.1%*
  - July +1.9% / +0.4%
- **8:30 am** Core PCE Price Index
  - **Aug. (e)** +0.3% / +1.5% y/y
  - *Consensus* *+0.3%* / *+1.4% y/y*
  - July +0.3% / +1.3% y/y
- **9:45 am** Markit Manufacturing PMI (Sep. F)
- **10:00 am** ISM Manufacturing PMI
  - **Sep. (e)** 55.0
  - *Consensus* *56.0*
  - Aug. 56.0
- **10:00 am** Construction Spending
  - **Aug. (e)** +0.7%
  - *Consensus* *+0.8%*
  - July +0.1%
- **Ward's Total Vehicle Sales**[D]
  - **Sep. (e)** 15.6 mln a.r.
  - *Consensus* *15.6 mln a.r.*
  - Aug. 15.2 mln a.r.
- Fed Speakers: New York's Williams (11:00 am), Governor Bowman (3:00 pm)
- 11:00 am 13-, 26- & 52-week bill, 3-, 10[R]-year note, 30[R]-year bond auction announcements
- 11:30 am 4- & 8-week bill auctions

Friday October 2
- **8:30 am** Nonfarm Payrolls
  - **Sep. (e)** +1,100,000
  - *Consensus* *+900,000*
  - Aug. +1,371,000
- **8:30 am** Unemployment Rate
  - **Sep. (e)** 8.2%
  - *Consensus* *8.2%*
  - Aug. 8.4%
- **8:30 am** Average Hourly Earnings
  - **Sep. (e)** +0.1% / +4.8% y/y
  - *Consensus* *+0.2%* / *+4.9% y/y*
  - Aug. +0.4% / +4.7% y/y
- **10:00 am** Factory Orders
  - **Aug. (e)** +0.8%
  - *Consensus* *+1.4%*
  - July +6.5%
- **10:00 am** University of Michigan Consumer Sentiment
  - **Sep. F (e)** 78.9[C]
  - Sep. P 78.9
  - Aug. 74.1
- Fed Speaker: Philadelphia's Harker (9:00 am)

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

Upcoming Policy Meetings | Bank of Canada: Oct. 28, Dec. 9, Jan. 20 | FOMC: Nov. 4-5, Dec. 15-16, Jan. 26-27

General Disclosures

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