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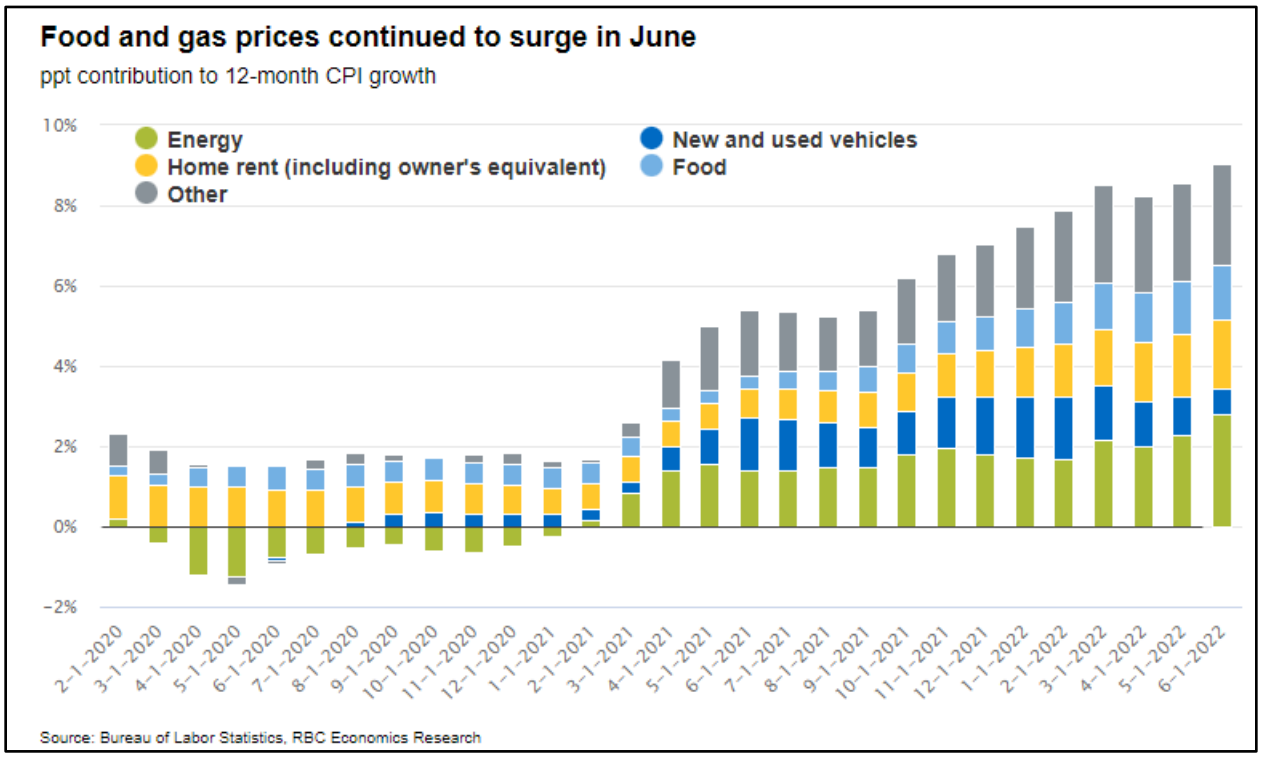
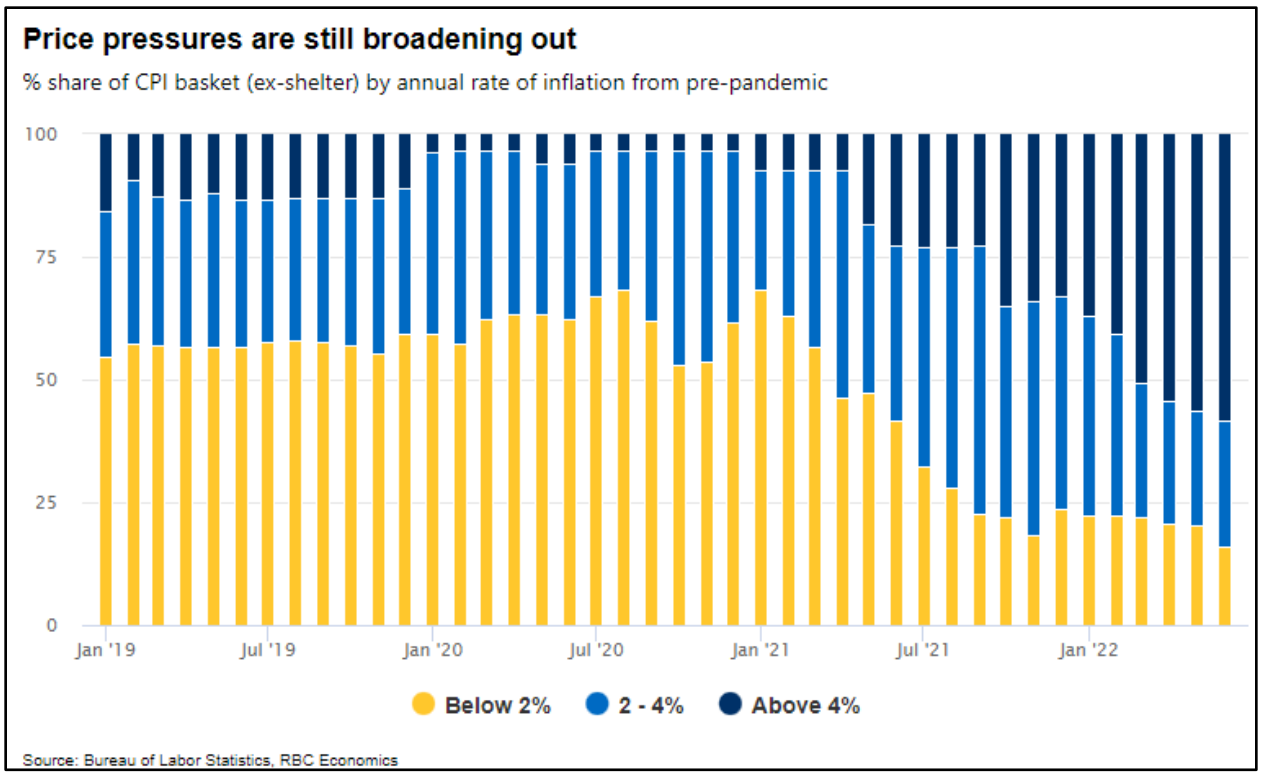
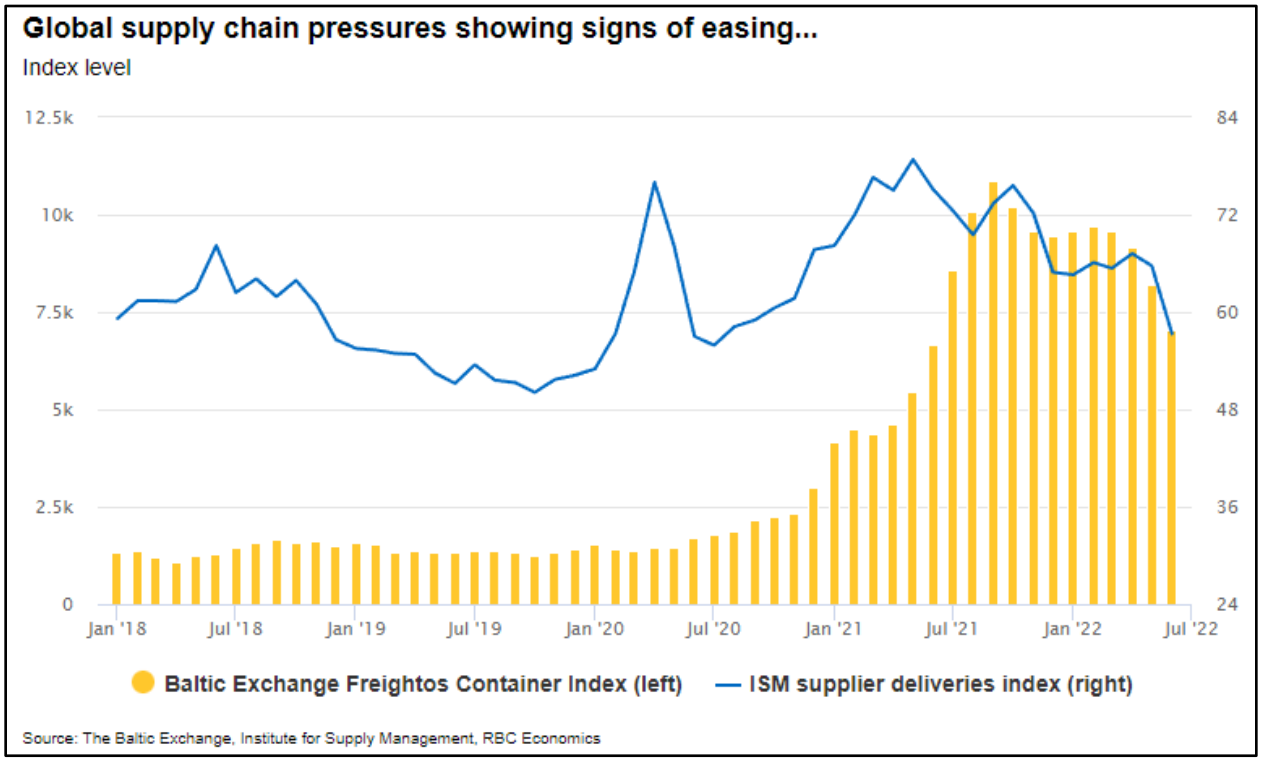
FOR EDUCATION PURPOSES ONLY

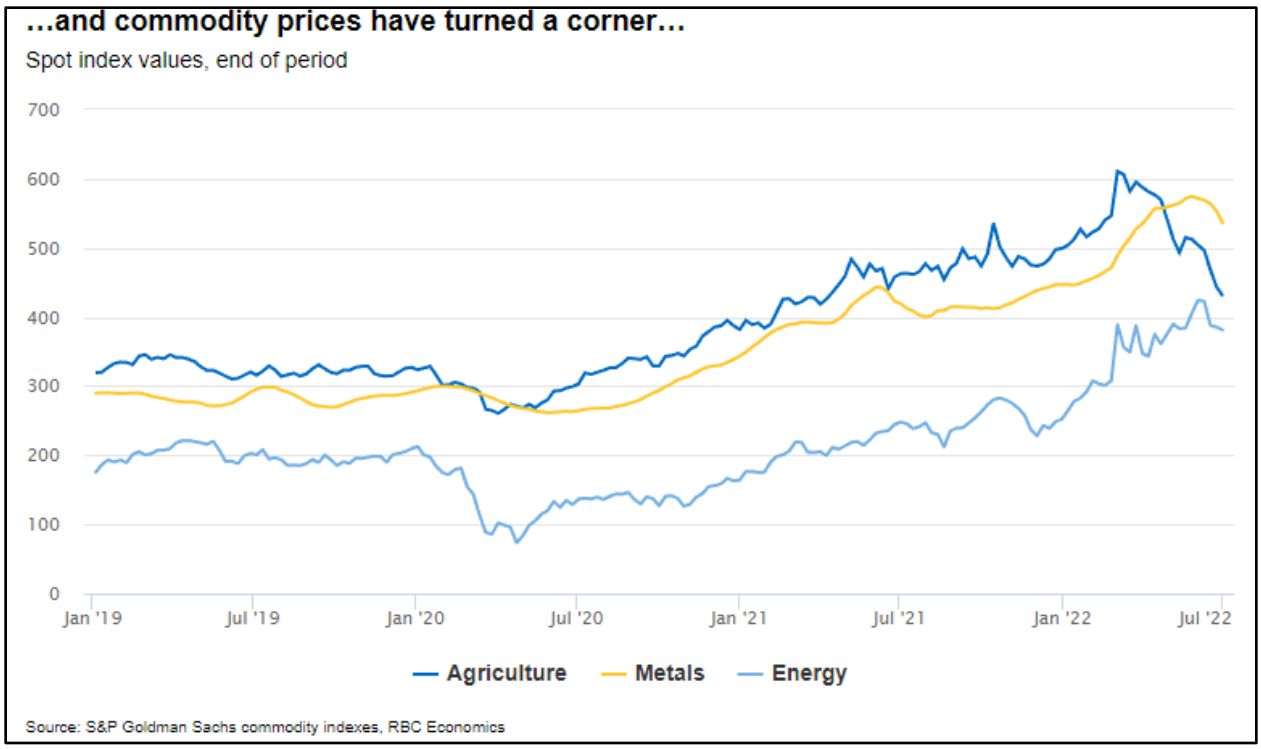
U.S. inflation close to peaking, but pressures still too broad for the Fed

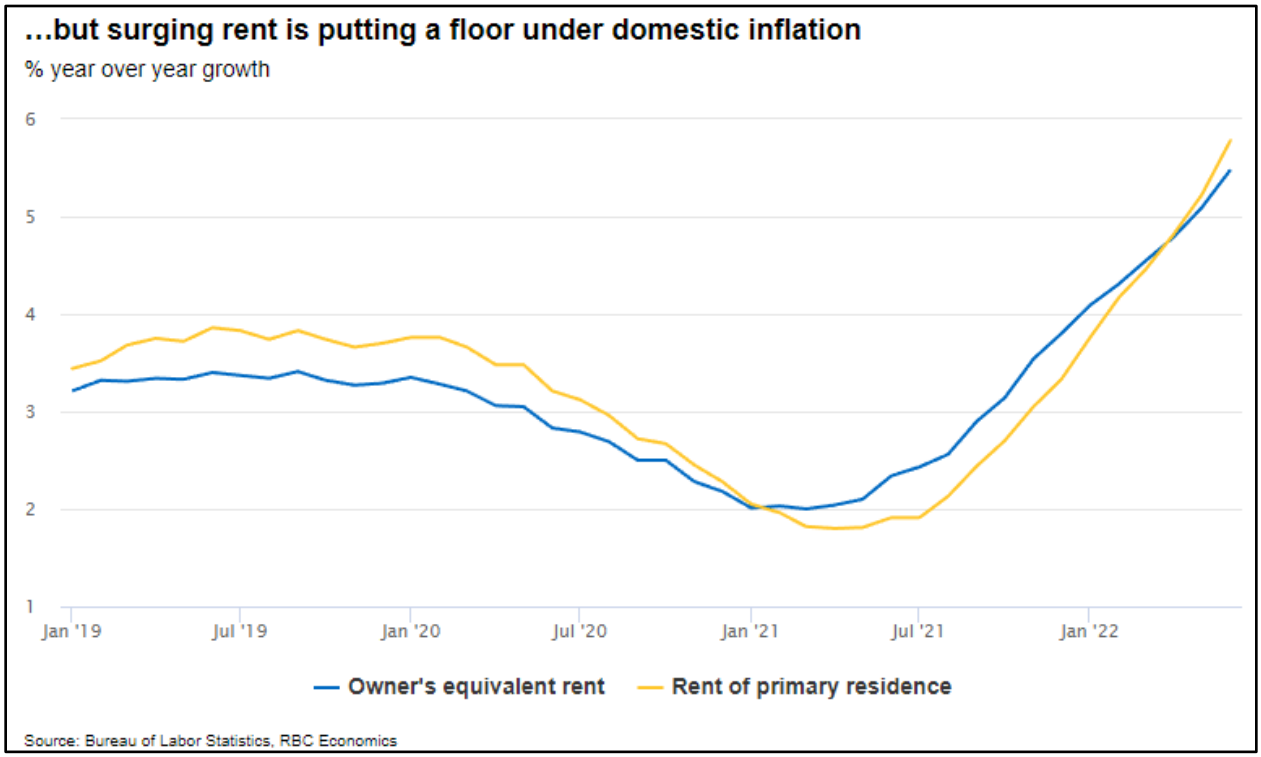
- CPI reading still rose in June on higher energy prices, but may be close to peaking
- Price pressures still very broad, but showing signs of plateauing as global supply chain disruptions ease and key commodity prices fall
- Rising rent costs to put a floor under core CPI readings, and underlying inflation trends still too strong to delay Fed rate hikes











Bank of Canada Interest Rate Announcement (July 13, 2022)

Bank of Canada delivers supersized 1% hike

- The Bank of Canada raised the overnight rate to 2.5% and stated that it will continue with Quantitative Tightening (QT).
- On rising prices, it stated that "inflation in Canada is higher and more persistent than the Bank expected in its April Monetary Policy Report (MPR), and will likely remain around 8% in the next few months."
- On economic growth, the Bank stated that it "expects Canada's economy to grow by 3½% in 2022, 1¾% in 2023, and 2½% in 2024. Economic activity will slow as global growth moderates and tighter monetary policy works its way through the economy. This, combined with the resolution of supply disruptions, will bring demand and supply back into balance and alleviate inflationary pressures."
- On today's surprise 1% hike, the Bank noted that "with the economy clearly in excess demand, inflation high and broadening, and more businesses and consumers expecting high inflation to persist for longer, the Governing Council decided to front-load the path to higher interest rates by raising the policy rate by 100 basis points today."

Key Implications

- The Bank of Canada cranks up the AC again in an effort to cool the economy. The supersized 100 basis point hike is its most aggressive move since the summer of 1998. If that feels like a long time ago, it was. Coincidentally, that summer Armageddon was topping the box office and the world was singing *"I Don't Want to Miss a Thing"*. Though this isn't Armageddon, this BoC meeting is not one to be missed.
- This big step up in rates is uncommon, so too is the economic backdrop. With the unemployment rate at 4.9%, wages running at 5.2%, and inflation at 7.7%, the pressure on the BoC has not let up. As we recently discussed in our updated Quarterly Economic Forecast, the hit to consumers from high inflation and rising rates will weigh on growth over the remainder of this year and into 2023. Though this raises the risk that the economy tips into recession (discussed here), the Bank has to accept this risk (and possible outcomes) in order to prevent high inflation expectations from becoming even more entrenched.
- All eyes will be on Governor Macklem in his upcoming press conference. If this is indeed "front loaded", then it may not be followed with another 1% move in September, and we could see something back in the 50 to

75 basis point range…although, that would still mean it's a supersized summer.

June Jobs Jumble

Canadian employment fell 43,000 in June, the first decline since January. But make no mistake, this is not a weak report. Oh, it's a quirky report, but not weak. All of the decline was among the self-employed (-59k), most of which were part-time positions (-39k)—not to be trite but think Uber drivers. Meanwhile, there were two jaw-droppings stats that drove home just how tight the job market has become: 1) The unemployment rate tumbled 2 ticks to 4.9%, the first time it has gripped the 4-handle since February 1970. 2) The average hourly wage measure shot up to 5.2% y/y, from 3.9% y/y the prior month, and an average rise of just 2.3% over the prior 12 months. Yes, the drop in the jobless rate is obviously a function of people dropping out of the labour force (again, the self-employed), but the participation rate of 64.9% is not particularly low (last year it averaged 65.1%). As well, the part rate for those 15-64 held steady at 79.4%. The major point is that workers are now extremely scarce. Finally, on the strong side of the ledger, note that total hours worked actually jumped 1.3% m/m and managed to rise at a 1.1% annualized rate for all of Q2.

By sector: In yet another sign that this was not a weak report, both construction (23k) and manufacturing (26k) posted strong gains, with additional help from government (15k) and transportation (11k). The big declines were in retail & wholesale trade (-61k), resources (-20k), and a variety of other service sectors. Notably, both of the "re-opening plays"—culture & recreation and hotels & restaurants—both declined more than 10k, as it appears those sectors just can't find help.

Regional movers: Only half the provinces saw job losses last month, but unfortunately two of them were the biggest. Quebec (-27k) and Ontario (-25k) were the main movers, while no province posted a particularly large gain—B.C. led with +6k. Jobless rate changes were all over the map, with Manitoba (3.8%) and Saskatchewan (3.9%) gripping the 3-handle and the lowest in the country. Quebec (4.3%) and B.C. (4.6%) were next in line, but both saw a small back-up in the month. But we simply must highlight what's going on in the east—Newfoundland's rate dipped a tick to 9.9%, the first time ever in single digits for that province, while PEI's rate plunged almost 3 percentage

points in a single month to 4.9% (for a province that used to be stuck with a high rate).

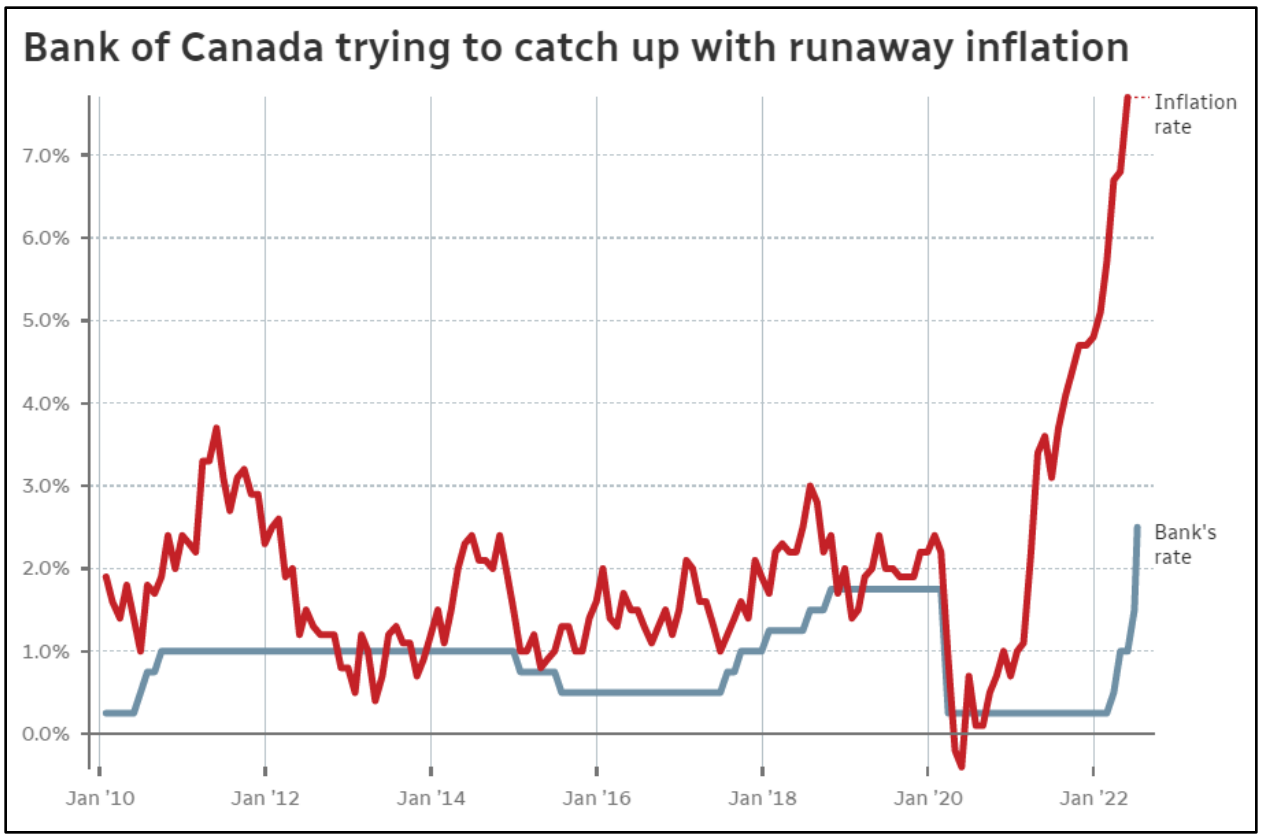
Bottom Line: Forget the messy headline number. The main takeaway here is that Canada has the tightest job market in generations, and now wages are starting to move with purpose. After remaining amazingly calm for the past year, the surge in average hourly wages to above 5% echoes a sudden upswing in wages from the payroll survey. Inflation has now landed with a thud in the job market, simply reinforcing the loud message for the Bank of Canada. We fully expect at least a 75 bp hike at next week's meeting.

Table 1 - Canada — Employment
(change in thousands)

				(avg. chng)	
	Jun	May	Apr	3-mo.	12-mo.
Total	-43.2	39.8	15.3	4.0	66.5
(month/month % change)	-0.2	0.2	0.1	0.2 [1]	4.2 [2]
Full-Time	-4.0	135.4	-31.6	33.3	66.1
Part-Time	-39.1	-95.8	47.1	-29.3	0.4
Goods Producing	32.5	-41.2	-16.0	-8.2	12.0
Manufacturing	26.3	-43.2	4.7	-4.1	3.1
Construction	23.0	-3.0	-20.7	-0.2	9.5
Service Producing	-75.7	80.9	31.4	12.2	54.4
Trade	-60.7	37.8	-17.9	-13.6	10.2
Unemployment Rate (%)	4.9	5.1	5.2	5.3 [3]	7.6 [4]
Avg. Hourly Wages (y/y % chng)	5.2	3.9	3.3	3.4 [3]	-0.1 [4]

1 (3-mo. % change : a.r.); 2 (y/y % change); 3 (3 mo. ago); 4 (12 mo. ago)

Source: BMO Economics, Haver Analytics



Challenges:

- Excessive interest rate hikes – slowdown in economy
- Modest interest rate hikes – inflation will continue to grow
- Supply Chain Challenges – China problem, cannot be controlled by BoC
- Global Economic growth – US/Europe & China dependent
- Crude Oil – Supply constraints e.g., OPEC+ limited supply
- Food inflation – global food shortage created by
    - Ukraine War
    - Climate Change activists – less fertilizer requirements etc., E.g., Sri Lanka
    - Cost of fuel

Bottom line: Fed Res & BoC have never got it right, first time around.

Our Take: Mild-recession forecast 2023, housing market decimated in short term.

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