THE PLAYBOOK

CI ASSANTE WEALTH MANAGEMENT

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Canadian unemployment rate hits new low

Source: Statistics Canada

MARKET FOCUS

Canada's job market tightens

The latest report from Statistics Canada revealed that the domestic economy added another 39,800 jobs during the month of May. At the same time, as can be seen in the accompanying graph, the unemployment rate slipped lower to 5.1%. The new unemployment rate is now the lowest on consistent records dating back to 1976. Using precursor data, this rate now matches the July 1974 (5.1%)

level. Total employment had recovered to the pre-pandemic level in October 2021. Since that time, job gains have averaged 71,200 per month. This compares to average monthly gains of just 25,400 over the same period heading into the pandemic. Further, average hourly earnings stood with annual growth of 3.9% in May. Still, this is well below the pace of inflation in April 6.8% – the fastest pace of inflation since January 1991 (6.9%). Unfortunately, the latest productivity data continue to paint a gloomy picture for inflation going forward. Canada's first quarter 0.5% *contraction* in labour productivity was sufficient to take it back to the level that prevailed in first quarter of 2018. In fact, the last time a productivity gain was recorded was the second quarter of 2020. In the absence of gains in productivity, only limited economic growth can be sustained without higher inflation.

U.S. inflation hits new high

The U.S. Bureau of Labor Statistics reported that the consumer price index rose 1.0% (seasonally adjusted basis) in May, following a 0.3% increase in April. On a year-over-year basis, the index was up 8.6% (on an unadjusted basis). This is above the 8.3% reported for April and is now the fastest pace of inflation since December 1981 (8.9%). The rapid acceleration of inflationary pressures to a 40-year high, amid sharply rising aggregate demand, has been the inevitable economic response to excessive fiscal and monetary policies. The persistence of "transitory inflation" has left modern monetary theorists heading back to their drawing boards. With the unenviable job of reigning in inflation and regaining credibility, the Federal Reserve raised rates by 75 basis points (a basis point is 1/100th of one per cent) at the June 15 policy window. This was the first interest rate hike of that size since November 15, 1994. The press release that accompanied the announcement stated that "the Committee is strongly committed to returning inflation to its two percent objective." It now appears likely that another 200 basis points of tightening is in the cards for the balance of 2022.

LONGER VIEW

Interest rates are at their bottom with the next move likely to be higher, and some investors are hung up on when this will take place. Judging by economic growth, unemployment rates and inflation, we believe the economies are ready for higher rates. So, anytime is fine as long as it is gradual and does not present a shock. We are confident central banks will be managing the hike cycle carefully. How much higher? We suspect the terminal rate is around 2%. A terminal rate is the maximum lending rate of a central bank at the end of a hike cycle. Two percent is substantially lower than normal; but it is important to recognize that we are in a "new normal" where the debt outstanding is significantly bigger, and lower is actually reasonable.

Economies typically start to slow as interest rates peak. We expect central banks to take their time to hike rates to 2%, in possibly two if not three years. Given that 2% is a low hurdle compared to corporate earnings growth, equity should continue to perform as it is obvious that certain sectors will fare better. Long-dated bonds, both 10-year Canada government bonds and U.S. Treasury bonds, are currently yielding below the terminal rate and unlikely to improve anytime soon.

For more information, we encourage you to speak to your advisor or visit us at assante.com

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