CIBC

Economic Insights

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Waiting For a Shot in the Arm

by Avery Shenfeld

If the coronavirus could talk, it would sound a lot like Arnold Schwarzenegger in the Terminator, who memorably promised, "I'll be back". Some regions that beat the virus down to extremely low levels, including China, South Korea, Taiwan and parts of Atlantic Canada, have thus far kept it that way, but Europe, the US and Canada's largest provinces are clearly in the throes of the battle to contain a second wave.

Retightened public health measures will be painful in the affected sectors, but are much, much narrower than what we saw in the spring. From February to May, Canada shed 2.3 million service sector jobs. About 1.8 million of those were recouped from May to September. If it were required across the whole country, the closure of indoor dining, bars and gyms could put 0.2 million positions at risk. Fingers are pointing at some other indoor activities (recreational hockey, for one) as risks that might be restricted, so the list of jobs at risk could grow a bit from here. But mask wearing has proven to be an effective weapon against the need for a broader shutdown.

Our September economic forecast had built in such risks from a second wave, without assigning it to a particular month. It was inherent in our assumption that the level of activity in mid-2021 would still be far from what would constitute a return to full employment, and that we wouldn't see anything remotely close to Q3's big GDP rebound in the next few quarters. So our current economic forecast (see page 2) isn't materially changed from the prior month's, as a markdown to Oct-Nov growth was roughly offset by an upward surprise to September employment, which we assume will also show up in the GDP figures. That's also meant no changes to our view on North American rates from what we printed a month ago.

While restaurant jobs could start to return before year end if all goes well, the same won't be true for those in sectors like live entertainment, convention centres, airlines, and some others that have been largely grounded since the pandemic began. Their lost output represents a lot of what's now missing in the economy, and the lack of Halloween and holiday season parties will dent retail sales gains to year end.

That underscores that to get the next big leg of North American growth, we're waiting for a shot in the arm. Literally. Until a vaccine (or potent therapeutic that tames the Covid tiger) is in place, the parts of the economy that have lagged will continue to do so. Vaccine candidates could be applying for approval before year-end, but experts suggest that wide-scale distribution, and the impact of greater community immunity on the prevalence of the disease, will be a story that begins closer to mid-2021.

Our optimism, and perhaps that of forward-looking equity markets, lies in what happens thereafter. This was by no means a typical economic slump, and some of its features actually lean towards a steeper recovery when we do get through what caused it: a public health crisis (see pages 3-7). The shot in the arm coming to protect us against Covid could be an even bigger economic shot in the arm than many now expect.

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Table 1

ECONOMIC UPDATE

CANADA	20Q1A	20Q2A	20Q3F	20Q4F	21Q1F	21Q2F	21Q3F	21Q4F	2019A	2020F	2021F	2022F
Real GDP Growth (AR)	-8.2	-38.7	48.1	2.4	2.1	2.5	4.3	6.2	1.7	-5.5	4.1	4.8
Real Final Domestic Demand (AR)	-7.5	-37.4	31.1	5.1	1.2	4.2	5.0	6.7	1.3	-6.2	3.5	5.2
Household Consumption (AR)	-12.4	-43.0	39.1	3.9	0.5	4.3	5.4	7.8	1.6	-8.3	3.3	6.1
All Items CPI Inflation (Y/Y)	1.8	0.0	0.2	0.2	0.7	2.0	1.9	2.1	1.9	0.6	1.7	1.9
Unemployment Rate (%)	6.3	13.0	10.0	9.1	8.9	8.6	8.3	7.6	5.7	9.6	8.3	6.8

U.S.	20Q1A	20Q2A	20Q3F	20Q4F	21Q1F	21Q2F	21Q3F	21Q4F	2019A	2020F	2021F	2022F
Real GDP Growth (AR)	-5.0	-31.4	33.0	2.1	1.3	2.2	5.9	6.6	2.2	-3.7	3.4	4.3
Real Final Sales (AR)	-3.6	-28.1	22.7	2.8	1.1	2.7	4.9	6.6	2.2	-3.2	2.8	4.3
All Items CPI Inflation (Y/Y)	2.1	0.4	1.2	1.4	1.7	2.9	2.4	2.4	1.8	1.3	2.4	2.2
Core CPI Inflation (Y/Y)	2.2	1.3	1.7	1.8	1.8	2.7	2.3	2.2	2.2	1.8	2.2	2.1
Unemployment Rate (%)	3.8	13.0	8.8	8.4	8.0	7.4	6.6	6.1	3.7	8.5	7.0	4.9

Table 2

INTEREST & FOREIGN EXCHANGE RATES

		2020		2021				2022	
END OF PERIOD:		**20-Oct**	**Dec**	**Mar**	**Jun**	**Sep**	**Dec**	**Jun**	**Dec**
CDA	Overnight target rate	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
	98-Day Treasury Bills	0.09	0.25	0.25	0.35	0.35	0.35	0.50	0.75
	2-Year Gov't Bond	0.23	0.35	0.35	0.40	0.40	0.65	0.50	1.00
	10-Year Gov't Bond	0.60	0.75	0.80	0.85	0.85	1.25	1.20	1.40
	30-Year Gov't Bond	1.20	1.20	1.30	1.40	1.50	1.80	1.60	1.65
U.S.	Federal Funds Rate	0.125	0.125	0.125	0.125	0.125	0.125	0.125	0.125
	91-Day Treasury Bills	0.10	0.20	0.25	0.25	0.30	0.50	0.45	0.75
	2-Year Gov't Note	0.15	0.25	0.30	0.30	0.35	0.55	0.50	0.80
	10-Year Gov't Note	0.79	0.80	1.00	1.10	1.25	1.45	1.35	1.55
	30-Year Gov't Bond	1.59	1.55	1.70	1.75	1.85	2.20	2.05	2.10
Canada - US T-Bill Spread		-0.01	0.05	0.00	0.10	0.05	-0.15	0.05	0.00
Canada - US 10-Year Bond Spread		-0.19	-0.05	-0.20	-0.25	-0.40	-0.20	-0.15	-0.15
Canada Yield Curve (10-Year — 2-Year)		0.37	0.40	0.45	0.45	0.45	0.60	0.70	0.40
US Yield Curve (10-Year — 2-Year)		0.64	0.55	0.70	0.80	0.90	0.90	0.85	0.75
EXCHANGE RATES	CADUSD	0.76	0.75	0.76	0.75	0.75	0.74	0.71	0.72
	USDCAD	1.31	1.33	1.32	1.33	1.34	1.36	1.40	1.39
	USDJPY	106	103	101	100	100	99	99	99
	EURUSD	1.18	1.17	1.17	1.18	1.19	1.20	1.20	1.20
	GBPUSD	1.30	1.29	1.29	1.31	1.31	1.32	1.32	1.33
	AUDUSD	0.70	0.69	0.70	0.71	0.72	0.73	0.74	0.76
	USDCHF	0.91	0.93	0.92	0.92	0.91	0.91	0.90	0.89
	USDBRL	5.58	5.10	5.00	5.20	5.00	4.50	4.80	4.50
	USDMXN	21.1	22.0	21.0	20.5	20.5	19.5	19.5	19.0

The Covid-19 Recession: It's Good to Be Different

by Andrew Grantham

Economic activity in both the US and Canada rebounded much faster than most expected during the reopening phase. However, momentum has started to slow again, Covid-19 case numbers are on the rise, and government support is slated to either ease slightly in Canada or potentially come to a sudden halt stateside. As a result, the North American economy will be in for a long, hard, winter.

But beyond that looming bleakness, which should be priced-in by markets at this point, investors need to look for the light at the end of the tunnel. That's not just about the increasing likelihood of a vaccine and, in the US, another attempt at a fiscal stimulus bill. There are also some positive differences between the current situation and past recessions that suggest that this recovery could enjoy an impressive acceleration as we move further into 2021 and beyond.

Serving Up a Smaller Hit Elsewhere

We've made the point before that an unusual facet of this recession is that it has been services-driven, both within the employment figures and within consumer spending. However, this isn't just a case of which sectors are the worst performers, there's a macro element as well.

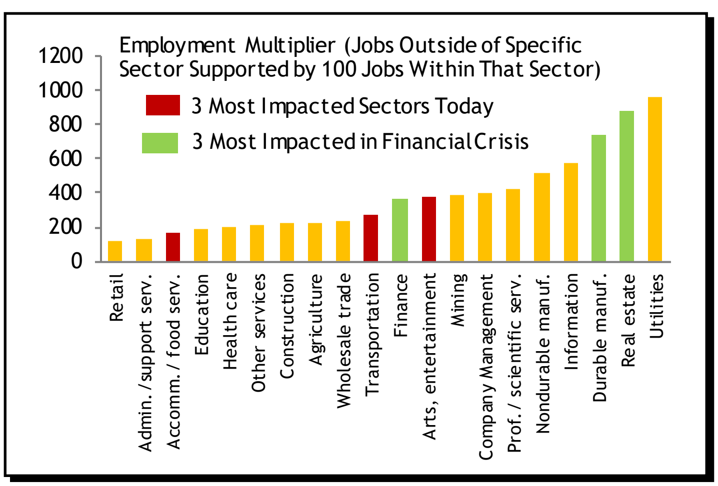
Many service industries, because they either don't require as many inputs from other sectors, or because the jobs are lower paying and don't support aggregate consumer spending to the same extent as others, don't see the same spillover effect from their weakness into other areas. This is particularly true given that government support has, at times, more than compensated for the lost income. Even without that, however, employment multipliers calculated from government data suggest that sectors seeing the greatest pain currently have lower multipliers than those that took the brunt of the financial crisis (Chart 1).

The result of this lower multiplier effect, as well as the income protection from government support, has meant that, severe job losses in the industries most impacted by social distancing needs haven't spread as much to industries outside the line of fire.

During the financial crisis, out of more than 100 industries, the 15 sectors hardest hit from the shock, including real estate, financial services and manufacturing, ended up accounting for only a third of the total job losses in the US. In this cycle, the 15 worst sectors, including hotels, restaurants and airlines, have accounted for more than half of the decline in jobs since February (Chart 2).

Chart 1

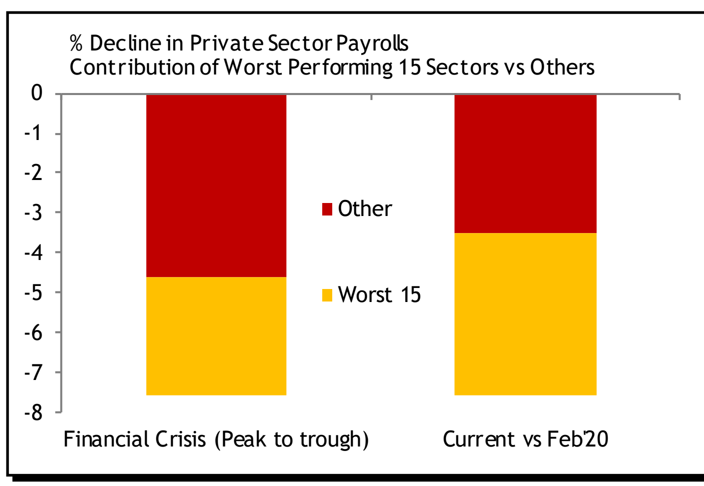
Service Industry Weakness Has Smaller Impact on Jobs Elsewhere



Source: BEA, BLS, Economic Policy Institute, CIBC

Chart 2

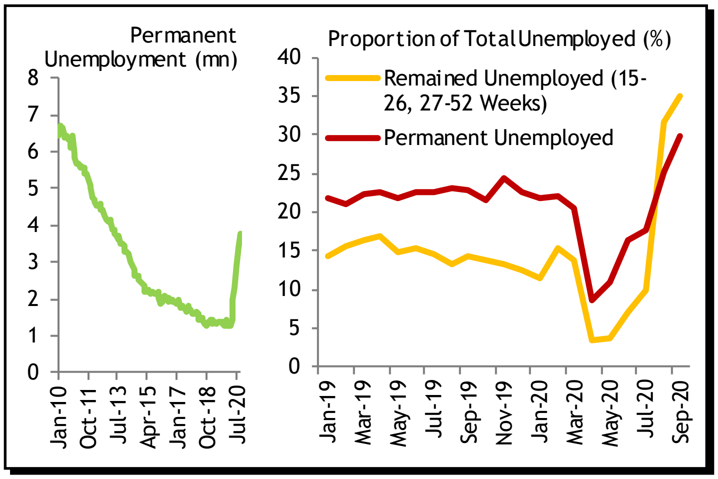
Job Losses More Concentrated This Time Around



Source: BLS, CIBC

Chart 3

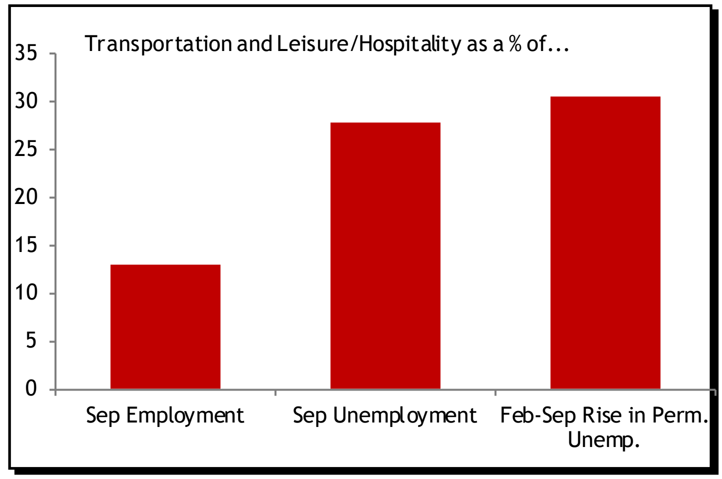
Permanent Unemployment on the Rise (L), As Early Job Losers Are at 6-Month Definition of Permanency (R)



Source: BLS, CIBC

Chart 4

Hardest Hit Sectors Have Even Larger Share of Permanent Unemployment



Source: BLS, CIBC

Moreover, other areas on aggregate have continued to gain back jobs at a stronger pace recently. The low multiplier from job losses in bars and restaurants will be helpful in minimizing the spillovers from renewed shutdowns in those sectors.

While the recovery in employment has still left a large, recession-sized hole in the labour market in both the US and Canada, the concentrated nature of the missing jobs gives hope for a rapid rebound when Covid is fully behind us. What the virus caused, the vaccine can cure.

Another area of concern recently has been the rising prominence of unemployed people describing their job loss as "permanent", rather than the "temporary" losses that were common earlier in the recovery (Chart 3, left). However, while it is true that some of these people could never return to their previous job and have to seek a new one, there could also be a definitional issue at play.

To be classed as temporarily unemployed, a person must either expect to return to the job within six months, or have been given a specific start date. An airline worker, for example, let go in April and now with little chance of returning within the six month period would be classed as a permanent job loser, even though the employer is still in business and will recall staff when the public decides that it is safe to travel again and when cross-border restraints are lightened.

There is therefore a strong relationship between the proportion of "permanent" unemployment and the proportion who have remained unemployed for between 15 and 52 weeks (Chart 3, right). Unpublished BLS data show that because of this, the hardest hit sectors of leisure & hospitality and transportation account for an even greater share of the rise in permanent unemployment than they do in total unemployment (Chart 4).

A job loss will only truly become permanent if the company in question either will not be able to return to pre-pandemic levels of operations even after a vaccine, or the company in question no longer exists. The last point brings us to another peculiarity of the current recession—the trends in business bankruptcies and formations.

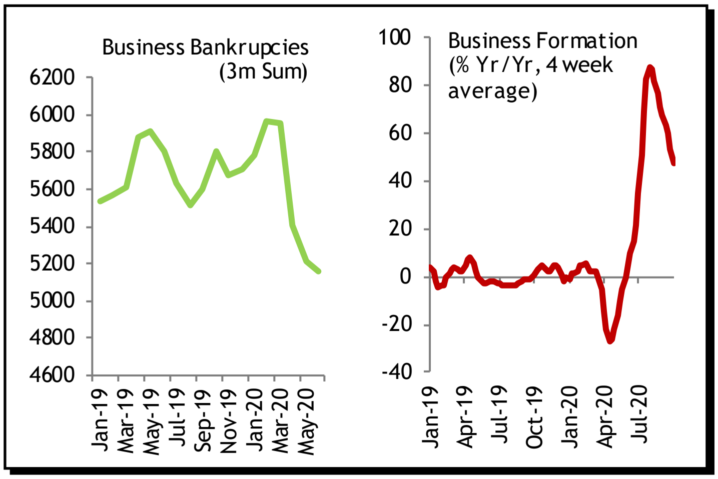
Hire Not Fire, Boom Not Bust?

Typically, during a recessionary period, businesses see their revenue decline, lay off staff and then some are forced to close their doors for good. However, thanks to the strength of government support thus far, total business bankruptcies have actually been lower than they were in 2019 (Chart 5, left). If that support is continued with a new fiscal package eventually agreed to, greater linkages will remain between employers and employees meaning that some of the permanent job losses described above may not prove permanent after all.

Perhaps even more unusual than the decline in bankruptcies has been the surge in new business formations since the pandemic struck, which again is not something we've typically seen in previous recessionary periods (Chart 5, right). Now, it is true that during the

Chart 5

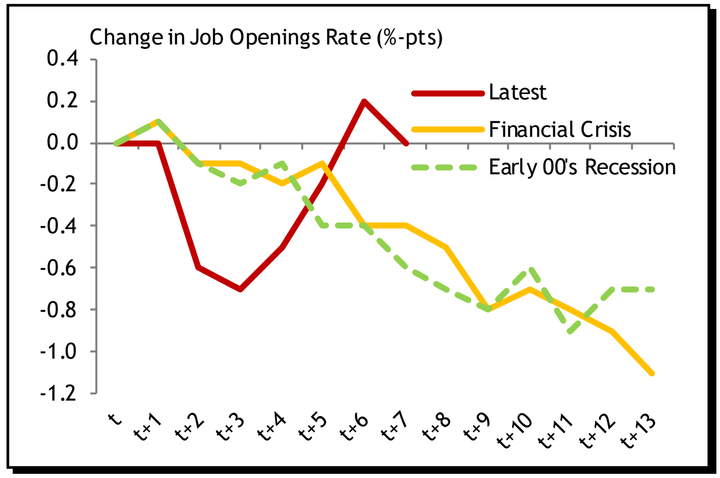
No These Lines Aren't The Wrong Way Around! Bankruptcies Down (L), Formations up (R)



Source: Fed, Census Bureau, CIBC

Chart 6

Job Openings Rate Has Recovered



Source: BLS, CIBC

earlier part of the recovery, many of these new formations were not listed as "high propensity", which meant that they were deemed unlikely to turn into companies with payroll. However, in Q3 there was a significant pick-up in those high-propensity applications as well. Because this is not a credit crisis, financial institutions have been willing and able to aid these new formations.

The surge in new business formation, coupled with stronger demand for some products/services and potentially a reluctance among some previous employees to return to work due to health concerns has resulted in another anomaly of the Covid-19 recession—a swift rebound in job openings.

The Job Openings and Labor Turnover Survey (JOLTS) doesn't get as much attention as it perhaps should, in part because we get the data with an apparently significant lag relative to non-farm payrolls. However, with the JOLTS survey taken at month-end, and payrolls during a survey week in the middle of the month, the lag isn't as big as it seems. Moreover, at the present time, the JOLTS data are showing some interesting trends.

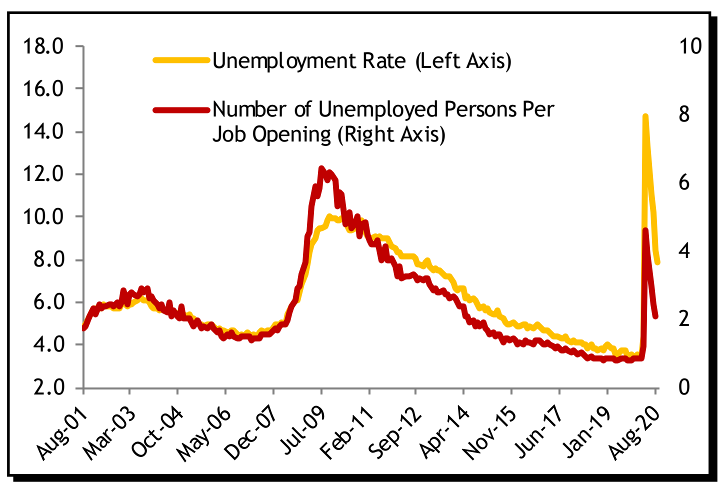
Having understandably cratered over the spring, the job openings rate has rebounded back to its pre-pandemic level in short order (Chart 6). This reflects a desire among firms to make new hires, as jobs filled by employees returning from temporary layoffs are not counted as an "opening". The swift rebound in job openings has contributed (along with the decline in unemployment in recent months) to the number of unemployed persons per job opening currently being below where it stood during not just the financial crisis but also the less severe recession of the early 2000's (Chart 7).

It's true that the relationship between job openings and unemployment (the Beveridge Curve) can change over time, and there is often a shift during recessionary periods due to a mismatch of labour skills to the jobs available. However, there's little reason to believe that such a skills mismatch should be so much larger this time around.

The US unemployment count has also, admittedly, been flattered by a greater number of people dropping out

Chart 7

Low Number of Unemployed Per Job Opening



Source: BLS, CIBC

of the labour force than is typical during a recessionary period. However, while that is certainly not a positive signpost, it has contributed to another interesting difference between the Covid-19 recession and previous downturns.

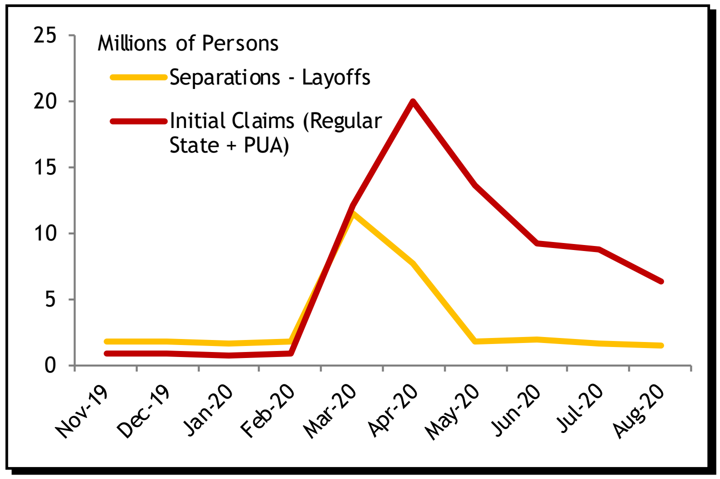
Typically, when a recession hits, those people who have been unemployed for the longest period of time find it even more difficult than normal to find work. Unpublished BLS data show that in the financial crisis, the probability of re-employment for someone who had been without a job for more than a year fell from around 12% to well below 10%. However, in recent months the long-term unemployed have actually seen a slightly greater probability of re-employment than prior to the pandemic (Chart 8). We use a 3-month average due to the volatility of the data, and to reduce the weight given to August which may have been lifted by census hiring.

The final peculiarity of the JOLTS data is the low rate of layoffs/discharges which were, as of August at least, even below the level seen in February (Chart 9). This is obviously at odds with the initial claims data and the news headlines we receive every Thursday stating that hundreds of thousands of Americans are still losing their jobs. It may demonstrate just how much the claims figures are being distorted by expanded qualifications for persons who have lost hours, are having to self-isolate and other new categories for eligibility.

While layoffs could admittedly be higher in the near-term, particularly after recent announcements of job losses from major airlines and a notable theme park, the fact that they haven't been anywhere near as strong as the claims data suggest is a positive sign, and ties back to the low levels of corporate bankruptcies and strong government support.

Chart 9

Are Layoffs a Lot Lower Than Initial Claims Suggest?



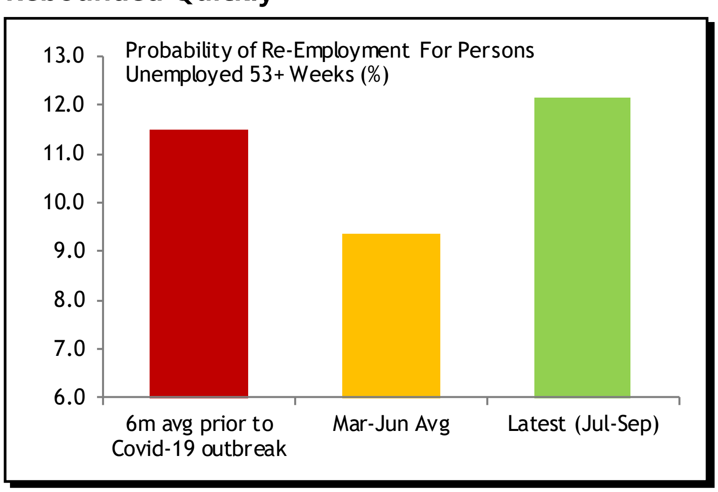
Source: BLS, CIBC

Can We Continue to be Different?

All of the differences described above are positive ones in relation to what typically happens during a recessionary period, and should mean that the recovery from this Covid-19 recession is quicker than the experience after the financial crisis and swifter than most policymakers currently expect. Indeed, we think that the US unemployment rate could fall quickly enough to warrant a rate hike from the Fed in 2023 (Chart 10), with the

Chart 8

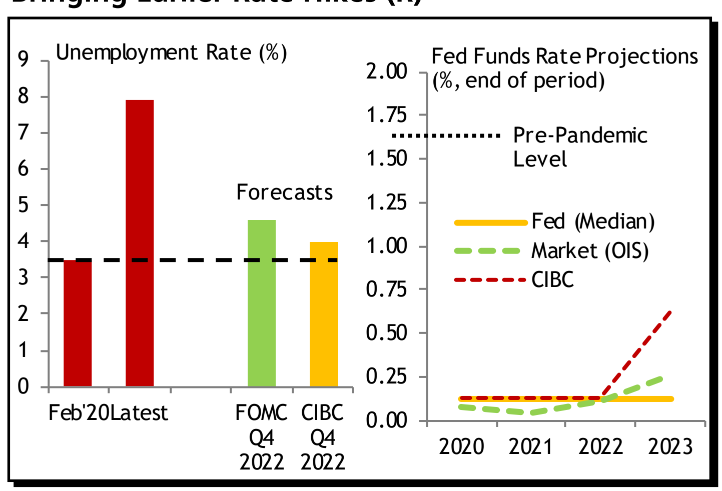
Re-employment Rate of Long-Term Unemployed Rebounded Quickly



Source: BLS, CIBC

Chart 10

Recovery Could Outpace Fed Expectations (L), Bringing Earlier Rate Hikes (R)



Source: Federal Reserve, BLS, CIBC

Bank of Canada likely lagging just behind that. That's in contrast to Fed chatter and market pricing that points even further out.

Our call does rest on a vaccine being widely available by mid-2021, and another round of stimulus no later than Q1. But assuming we get both, there should be some better-than-expected news for the US, and by extension Canada, if we look past a gloomy winter.