



FCC Economic and Financial
Market Update

2021 Q3

Published on September 2, 2021

Outlook

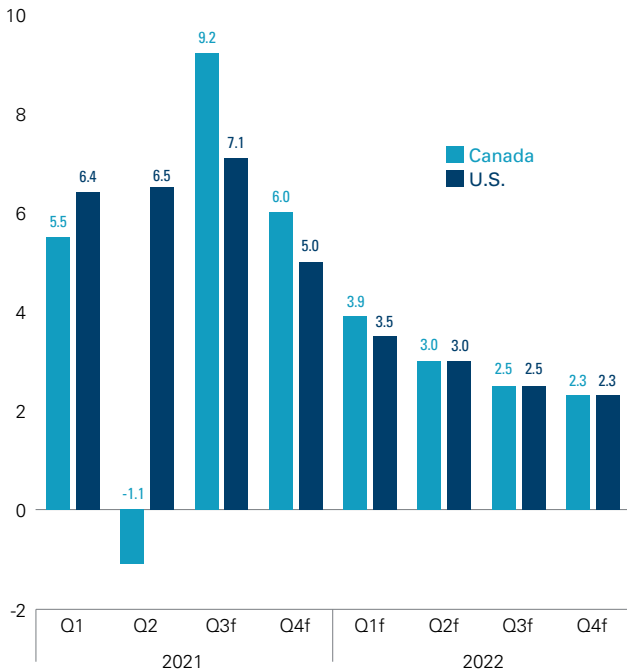
The rollout of COVID-19 vaccines and the lessening of restrictions have boosted Canadian consumer spending. The rise of the Delta variant globally and in Canada could slow the recovery, potentially impeding 2021 GDP growth. Canadian GDP is expected to grow by 7.6% during the second half of the year, headlined by stronger consumer spending in services and strong oil prices, finishing the year 6.2% higher and above pre-COVID levels. Inflation is expected to average 3.4% during the second half of the year and 2.9% for 2021. The Bank of Canada (BoC) overnight rate is expected to remain unchanged in 2021 at 25bp before rising in Q3 2022.

GDP

GDP growth is expected to be strong for the second half of the year (Figure 1). The consensus forecast calls for GDP growth of 9.2% in Q3 and 6.0% in Q4 as economic activity is boosted after a contraction in Q2. COVID's third wave lowered household consumption expenditures in food services and travel, impacting first-half growth. However, savings have continued to build up (Figure 2) and will support growth during the second half. The entirety of the \$170 billion in additional savings isn't expected to be spent immediately, but consumption should steadily increase over the next year. International travel restrictions for Canadians could benefit the local economy as money is spent domestically. A rise in global cases related to the delta variant could lessen export growth; however, exports are still expected to be relatively strong as prices remain elevated.

Figure 1. Second half GDP should be strong

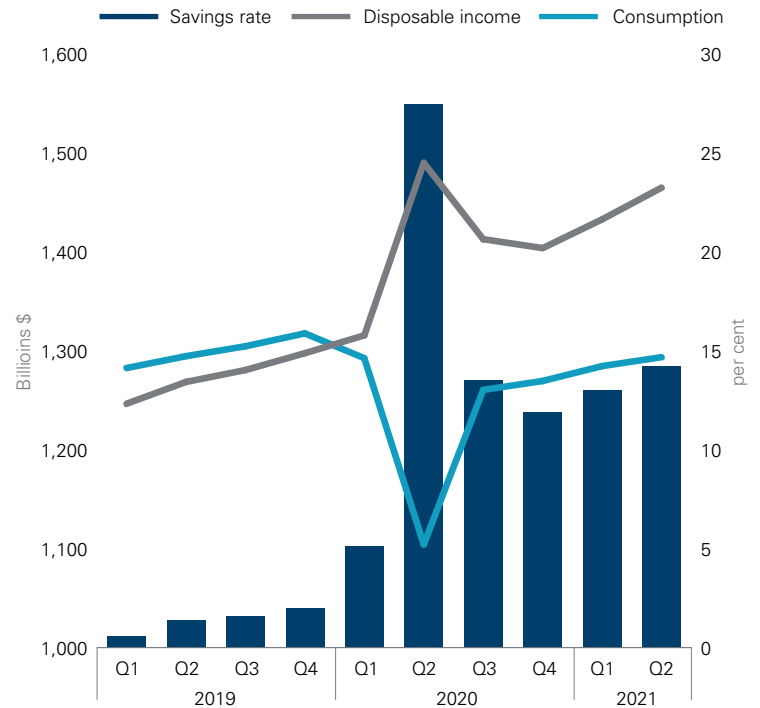
Quarterly GDP quarter-over-quarter percent change
Seasonally adjusted at annual rates



Source: Bloomberg

Figure 2. \$170 billion gap between savings & consumption

Household savings and consumption
Billions \$ and saving rate (%)



Source: Statistics Canada

FCC attempts to provide accurate and useful information and analysis. The contents herein have been compiled or derived from sources believed to be reliable, however, FCC cannot guarantee the accuracy of the information contained in this report. All estimates and opinions within this report constitute judgments as of the date of this report and are subject to change without notice. FCC makes no representation or warranty, express, or implied, in respect to this report, and takes no responsibility for any errors or omissions which may be contained herein. FCC accepts no liability whatsoever for any loss arising from any action or decisions taken by any reader of this report based on information provided in this report.

Central Bank Policy and Bond Markets

The Bank of Canada overnight policy rate and variable rates

The Bank of Canada (BoC) is projected to increase its overnight rate by 25bp in Q3 2022 (Table 1). The BoC lowered their weekly bond purchases another \$1 billion to \$2 billion in July from the height of \$4 billion. We do not expect purchases to completely end in 2021, and variable rates should continue at historic lows through the first half of 2022. As the economy recovers and economic risks ease, some variable rates have declined recently but there's little room for further reductions.

Table 1. Bank of Canada target overnight policy rate expected to increase in Q3 2022

%, end of period

	2021				2022				Annual		
	Q1	Q2	Q3f	Q4f	Q1f	Q2f	Q3f	Q4f	2020	2021f	2022f
Bank of Canada overnight target rate	0.25	0.25	0.25	0.25	0.25	0.25	0.50	0.50	0.25	0.25	0.50

Sources: FCC, Bank of Canada

Inflation and fixed rates

Headline inflation from Statistics Canada was 3.4% year-over-year (YoY) in Q2 and 3.7% in July, led by increases in energy and transportation. The annual expectation for 2021 is 2.9% (Table 2). We expect inflation numbers to lower into Q4 but remain above the 2% target going into 2022.

Food is a different story. Food inflation increased 1.2% in Q2, 1.7% in July, and is expected to increase throughout Q3/Q4. Food manufacturing prices increased 7.4% YoY in Q2. Raw materials inflated 26.6% because of persistent supply chain constraints, and total wage compensation is up 11.6% YTD. Many manufacturers have been slowly passing on price increases to customers to avoid large swings and in hopes that costs soon lower, but this has put pressure on margins. If costs do not retreat soon, consumer food prices will be driven higher at a time when non-food inflation is expected to ease.

Table 2. Headline inflation will start to decline in the second half but remain elevated

Inflation, year-over-year % change in headline Statistics Canada CPI

	2020				2021				2022				Annual averages		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3f	Q4f	Q1f	Q2f	Q3f	Q4f	2020	2021f	2022f
Canada	1.8	0.0	0.2	0.8	1.4	3.4	3.5	3.3	2.8	2.2	2.1	2.1	0.7	2.9	2.3
U.S.	2.1	0.3	1.2	1.3	1.9	4.9	4.4	4.3	3.8	2.6	2.2	2.2	1.2	3.9	2.7

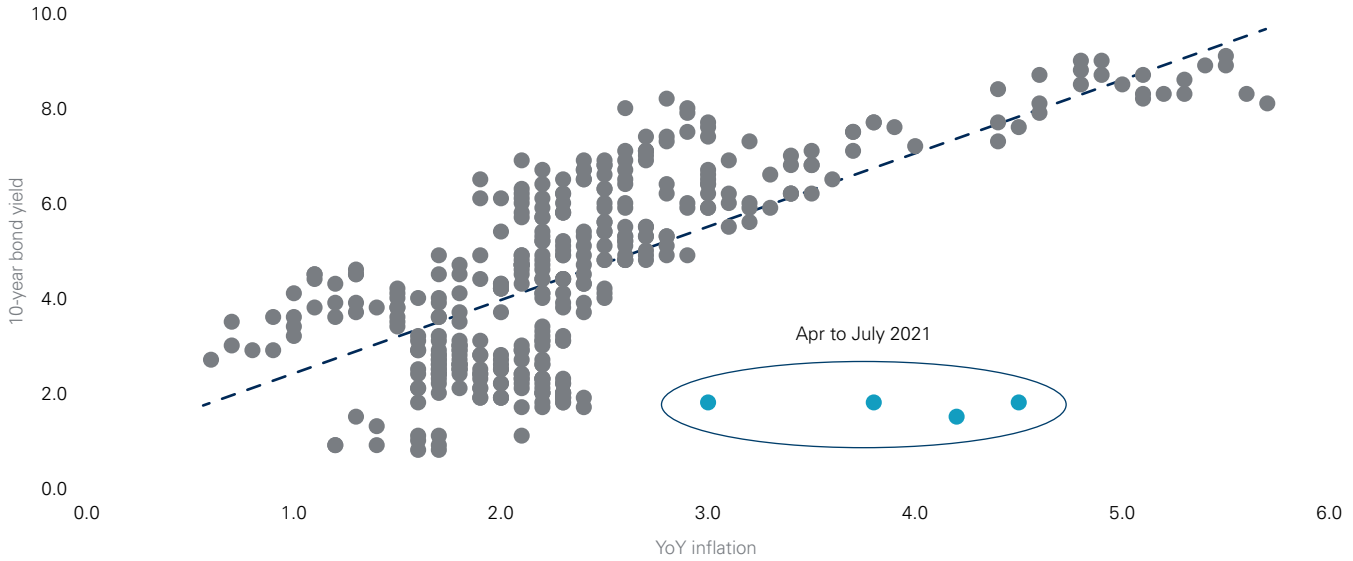
Sources: Bloomberg, Statistics Canada

Long-term bonds drive fixed ending rates and tend to follow core inflation numbers, so don't expect BoC policy changes from higher food prices. The 10-year U.S. bond yield has mostly ignored higher inflation numbers this year, declining over the summer feeding the transitory inflation storyline (Figure 3). Canadian bond yields generally follow U.S. bonds and remain well below the five-year average. Markets are still dealing with an influx of central bank stimulus, but the pessimism of the bond market needs attention: Growth and inflation over the next one to three years may not be as strong as some expect.

FCC attempts to provide accurate and useful information and analysis. The contents herein have been compiled or derived from sources believed to be reliable, however, FCC cannot guarantee the accuracy of the information contained in this report. All estimates and opinions within this report constitute judgments as of the date of this report and are subject to change without notice. FCC makes no representation or warranty, express, or implied, in respect to this report, and takes no responsibility for any errors or omissions which may be contained herein. FCC accepts no liability whatsoever for any loss arising from any action or decisions taken by any reader of this report based on information provided in this report.

Figure 3. U.S. government bond yields are diverging from inflation

U.S. 10-year bond yield vs CPI inflation excluding energy and food
1990-2021, monthly



Source: Federal Reserve

The economic recovery will largely drive movement in fixed-term lending rates and whether inflation is transitory. If the economy recovers as expected and supply chains gain back normality, inflation will likely be more transitory and inflationary pressures will soften, reducing pressure on the BoC to raise rates. Regardless, businesses should be prepared for an increase in rates within a year given the direction provided by the Central Bank.

Exchange rates

USD per CAD

The Canadian dollar retreated from highs in Q2 after the Federal Reserve started talking about potentially tapering bond purchases before the end of the year and increasing its policy rate in 2023. This, along with a COVID resurgence in the U.S. and worldwide, has questioned the strength of the economic recovery and overall commodity demand, resulting in a softer loonie. The Canadian dollar is projected to average 0.792 during the second half of the year (up 4.3% YoY) and average 0.786 during 2022 (Table 3). The current outlook has oil prices weakening during the second half of the year, dragging the dollar down into 2022. Further in 2022, the expectation is that a more hawkish Fed stance will further deteriorate the loonies' value.

Table 3. CAD projected to decline heading into 2022

Exchange rates, quarterly averages

	2020				2021				2022				Annual averages		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3f	Q4f	Q1f	Q2f	Q3f	Q4f	2020	2021f	2022f
U.S. per CAD	0.745	0.722	0.751	0.768	0.790	0.814	0.793	0.791	0.789	0.787	0.786	0.784	0.747	0.797	0.786

Sources: Statistics Canada, FCC

FCC attempts to provide accurate and useful information and analysis. The contents herein have been compiled or derived from sources believed to be reliable, however, FCC cannot guarantee the accuracy of the information contained in this report. All estimates and opinions within this report constitute judgments as of the date of this report and are subject to change without notice. FCC makes no representation or warranty, express, or implied, in respect to this report, and takes no responsibility for any errors or omissions which may be contained herein. FCC accepts no liability whatsoever for any loss arising from any action or decisions taken by any reader of this report based on information provided in this report.

CNY per CAD

Economic growth is slowing in China. GDP grew a strong 7.9% YoY in Q2, but below expectations and well below the 18.3% growth observed in Q1. GDP is anticipated to grow in the 3% range for the second half of 2021. Pre-COVID growth in 2019 was 6.1%. With a resurrected American economy, China is falling behind its global counterparts and is implementing financial support to boost its economy. The People's Bank of China cut the reserved requirements for banks in July, and a cut to the country's benchmark loan rate could be next. China's reserve rate is highly correlated to the USD exchange rate and declined on the reserve announcement. Further devaluation of the Renminbi could be in order.

EUR per CAD

The European Central Bank (ECB) remains committed to supporting the economy and will continue to provide stimulus stating there is a long way to go before economic damage is offset. According to the IMF, Europe's response to fiscal stimulus has been more muted than North America and is not expected to see its GDP fully recover until 2022. In July, the ECB changed its inflation policy, allowing inflation to run temporarily above 2% to reach long-term growth objectives that now include climate goals. A faster-moving Canadian economy could put further upward pressure on the CAD relative to the Euro.

GBP per CAD

The Bank of England (BoE) did not make any policy changes in their August meeting, partially due to the uncertainty on how the economy will handle the end of the Government's wage benefit program. It did, however, paint a rosy picture for growth in the coming months. The British economy is projected to increase 7.25% in 2021, a pace above both Canada and the U.S. The Pound has increased in value on this optimism, and the outlook is bullish. Relative to the loonie much depends on whether commodity prices continue to increase.

Table 4. Historical currency rates per CAD for CNY, EUR and GBP

Exchange rates, quarterly averages

	2020				2021			Annual averages	
	Q1	Q2	Q3	Q4	Q1	Q2	Q3 to date	2020	2021 year to date
CNY per CAD	5.194	5.118	5.192	5.083	5.120	5.259	5.166	5.147	5.185
EUR per CAD	0.675	0.655	0.642	0.644	0.656	0.676	0.676	0.654	0.668
GBP per CAD	0.582	0.582	0.581	0.581	0.573	0.582	0.577	0.582	0.578

Source: Bank of Canada

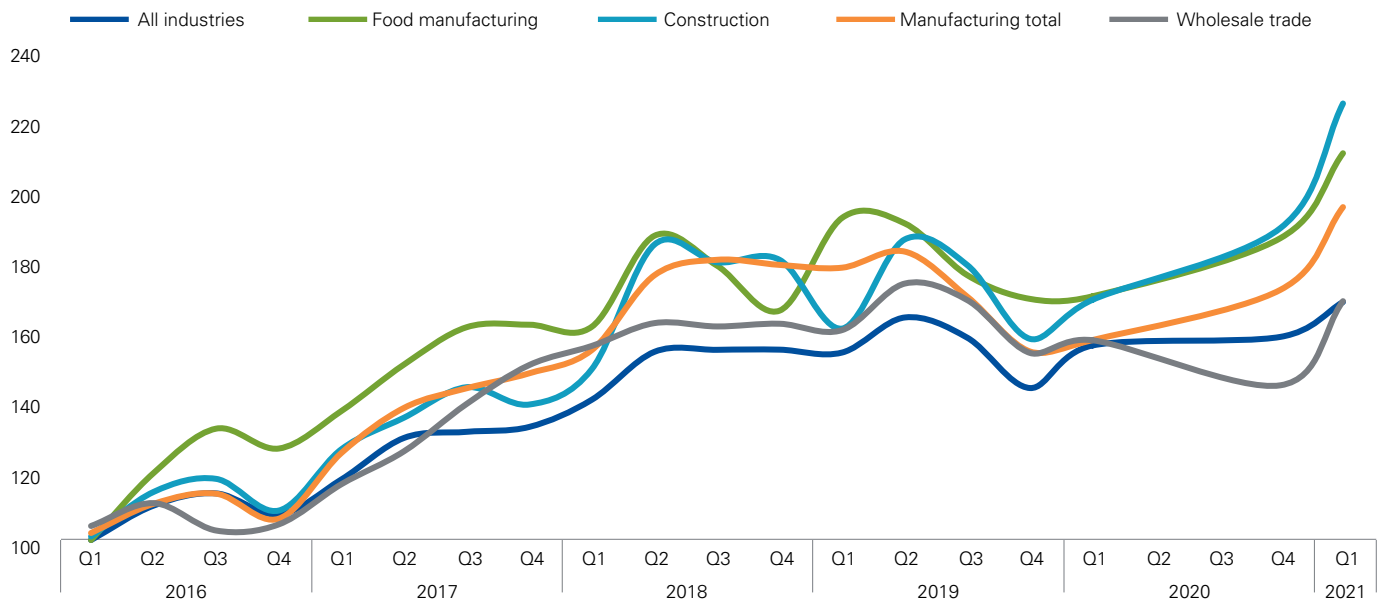
FCC attempts to provide accurate and useful information and analysis. The contents herein have been compiled or derived from sources believed to be reliable, however, FCC cannot guarantee the accuracy of the information contained in this report. All estimates and opinions within this report constitute judgments as of the date of this report and are subject to change without notice. FCC makes no representation or warranty, express, or implied, in respect to this report, and takes no responsibility for any errors or omissions which may be contained herein. FCC accepts no liability whatsoever for any loss arising from any action or decisions taken by any reader of this report based on information provided in this report.

Labour market recovery

Canadian job vacancies are increasing with the re-opening of the economy as businesses struggle to hire qualified employees (Figure 4). Many businesses are considerably increasing wages or offering overtime to meet workforce demands. The labour market is expected to return to pre-COVID normalcy as the economy re-opens. Immigration is picking up after falling in 2020 (up 57.3% YoY thru July and flat with the five-year pre-COVID average) which will help fill gaps for skilled and unskilled labour. Canada is on pace to accept a record amount of new permanent residents in 2021, beating the 1913 record where 400,810 immigrants came to Canada.

Figure 4. Job vacancies have jumped in many industries in 2021 as the economy re-opens

Job vacancies by industry, seasonally adjusted (Index Q1 2016 = 100)



Source: Statistics Canada

FCC attempts to provide accurate and useful information and analysis. The contents herein have been compiled or derived from sources believed to be reliable, however, FCC cannot guarantee the accuracy of the information contained in this report. All estimates and opinions within this report constitute judgments as of the date of this report and are subject to change without notice. FCC makes no representation or warranty, express, or implied, in respect to this report, and takes no responsibility for any errors or omissions which may be contained herein. FCC accepts no liability whatsoever for any loss arising from any action or decisions taken by any reader of this report based on information provided in this report.



For more agriculture and food economics insights, visit fcc.ca/Economics

Cette publication est également offerte en français.