Darkest Before the Dawn

A Publication of BMO Capital Markets Economic Research • Douglas Porter, CFA, Chief Economist, BMO Financial Group

ECONOMIC RESEARCH
+1 (416) 359-6372
economics.bmo.com

Douglas Porter, CFA, Chief Economist
+1 (416) 359-4887
douglas.porter@bmo.com

This week brought the **first full-fledged detail of the heavy economic toll** in North America from the pandemic, at the same time as the virus spread more aggressively, and the expected shutdown timeline lengthened. Even in the face of this generally tough news on the economic and health fronts, financial markets took it mostly in stride, weakening moderately with volatility climbing off the mountain top. The one true surprise of the week was a series of hints, including Presidential tweets, that there may be a **partial détente in the devastated oil market**. As a result, the biggest move was a near-30% rebound in oil prices, taking WTI above $27, stabilizing the Canadian dollar just below 71 cents ($1.415), and helping the TSX to a small gain on the week. But that gain was an outlier, and the good news ended there.

On the economic front, the turn of the calendar brought the first wave of March monthly data, which gave the initial read on the impact of the shutdowns. Given that the closures arrived in a stages through the month, analyzing the results almost became an exercise in dividing figures into before and after. **U.S. employment figures** were the main act, with the staggering rise in initial jobless claims last week of 6.65 million the most devastating news. The fact that seasonal adjustment factors alone added 825,000 folks to the latest claims tally dulled the blow from the reported 701,000 decline in March payrolls the next day. Much less noted was that the companion household survey reported a massive 3 million job loss for last month, easily the largest drop ever. Suffice it to say, these figures will all deteriorate much further in April, even if they were already much worse than expected last month.

While the job market is taking the immediate and obvious hit from the economic deep freeze, other indicators were mixed. **U.S. consumer confidence** stepped back by roughly 10% last month to 120 according to the Conference Board, but the index is still miles above the 2009 low of just 25.3. **Auto sales** crumbled 35% y/y to 11.4 million units, as strong first-half activity fell to almost nothing in late-March. Notably, the drop in Canadian auto sales was even heavier at down 47%, and consumer sentiment fell much further, reflecting a slightly earlier economic shutdown. Meanwhile, sentiment among U.S. firms last month softened only modestly for both **manufacturers and services**—the factory ISM dipped to 49.1 (admittedly held up by supplier delivery delays, so the "real" number was closer to 45), while the non-manufacturing index shocked with a still-solid 52.5 reading (also finding artificial support from supplier delays).

Look for a widening split between manufacturing and services in coming months, with the latter likely to take a heavier hit. That's a clear theme we have seen play out across other economies dealing with the physical distancing. And, it's the **exact opposite trend normally seen in a "typical" economic downturn**. In more normal times, it's manufacturing that takes it on the chin, while services hold up relatively well. But the unique nature of this episode, and the mandated closures of many service sectors, has totally turned the tables. For example, the U.K. services PMI tanked to 34.5 in March, while manufacturing was 47.8; the Euro area figures were even starker at 26.4 for services and 44.5 for factories. That's the kind of split we are likely to see in April in North America as well.

Just as the nature of this recession is so unusual (services versus factories), **the shape of the recovery is also likely to be quite different**. No question, the conventional wisdom on the timing and strength of the recovery took a turn for the worse in recent days, amid the tougher news on the path of the virus. And, ultimately, the **depth** and the **duration** of the downturn will be **dictated by the virus**. But, the recovery may well be more forceful and somewhat faster than generally expected when it arrives, because of this unusual split between sectors. There will be no inventories to work down in services; when they can open for business again, they will be in a position to ramp up quickly. No doubt, many industries will be facing a long workout period based on behavioural changes alone (think travel, entertainment), but the dramatic swell in fiscal measures should support spending in other areas.

Looking ahead to next week, it's a lighter data calendar for the U.S., although jobless claims are expected to post yet another massive reading of just under 6 million. But as so vividly seen this week, financial markets have long since built in very ugly employment assumptions—the **bigger question** is **how long** the shutdowns linger, not how deep they cut. The much more secondary issue of falling inflation will be addressed by Friday's CPI read, and it's expected to show a sharp drop to around 1.5% y/y from 2.3%. It won't stop there on the way down. In Canada, the focal point will be the March employment data, due on Thursday (ahead of Good Friday). With the survey taken a week later than the U.S. jobs report, it is likely to sustain a relatively deeper hit than the weaker-than-expected stateside data. We have pencilled in a 600,000 decline in jobs, or five times the worst month ever for the LFS (a 124,800 drop in January 2009). Again, we suspect the markets are now essentially numb and/or fully prepared for such news.

On the forecast front, for the first time in weeks, we have no significant changes to report. For oil, we had been assuming that eventually OPEC or Russia would buckle, and had stuck with a call of $35 WTI for this year. That may still prove optimistic if a solid agreement on large output cuts (at least 10 million bpd) can't be reached at the emergency virtual OPEC+ meeting. Elsewhere, the lack of a forecast change does not necessarily mark the end of revisions. In fact, with the timeline on shutdowns apparently poised to get pushed out further, and potentially much further, the growth estimates will necessarily need to reflect this as more information arrives. The offset is that fiscal policy appears poised and prepared to ramp up as needed to counter the deepening drag on incomes from the shutdowns, and presumably support a comeback in spending later this year.

Another big adjustment this week was the **budget deficit estimates in Canada**. We noted that last Friday's sudden announcement of a 75% wage subsidy was going to carry a very large price tag, potentially doubling the deficit estimate in a stroke. And so it did. The 12-week program is expected to cost $71 billion, lifting new direct fiscal support to $105 billion, according to Finance Minister Morneau. That comes on top of an underlying deficit of $28 billion before any of this began, as well as the surge in costs and slump in revenues naturally flowing from the economic blow. We believe it's far too early to try to put a pin in precisely how big the deficit will be, but let's just say that the **modern day record of 8% of GDP** (which translates to about $180 billion) is **clearly at risk**. If anything, that looks light.

To those who are deeply, and understandably, quite concerned about this sudden and dramatic turn in the deficit—from 1% of GDP to over 8%—I would say four things:

1. What choice do we really have, given the mandated shutdown of the economy?
2. It's much better that Ottawa shoulders the burden of almost all new spending than a hodge-podge effort by the provinces, especially in light of lower borrowing costs for the federal government.
3. On that point, Ottawa can now borrow at all terms of 10 years or less for under 0.7%. So, the annual interest cost of an additional $200 billion may be less than $1.5 billion.
4. Finally, the Bank of Canada is essentially financing the net new borrowing, at least for now, by buying "*at least*" $5 billion of GoCs per week. That QE could build to nearly $200 billion by the end of 2020.

General Disclosures

"BMO Capital Markets" is a trade name used by the BMO Investment Banking Group, which includes the wholesale arm of Bank of Montreal and its subsidiaries BMO Nesbitt Burns Inc., BMO Capital Markets Limited in the U.K., Bank of Montreal Europe Plc in Ireland and BMO Capital Markets Corp. in the U.S. BMO Nesbitt Burns Inc., BMO Capital Markets Limited, Bank of Montreal Europe Plc and BMO Capital Markets Corp are affiliates. BMO does not represent that this document may be lawfully distributed, or that any financial products may be lawfully offered or dealt with, in compliance with any regulatory requirements in other jurisdictions, or pursuant to an exemption available thereunder. This document is directed only at entities or persons in jurisdictions or countries where access to and use of the information is not contrary to local laws or regulations. Their contents have not been reviewed by any regulatory authority. Bank of Montreal or its subsidiaries ("BMO Financial Group") has lending arrangements with, or provide other remunerated services to, many issuers covered by BMO Capital Markets. The opinions, estimates and projections contained in this report are those of BMO Capital Markets as of the date of this report and are subject to change without notice. BMO Capital Markets endeavours to ensure that the contents have been compiled or derived from sources that we believe are reliable and contain information and opinions that are accurate and complete. However, BMO Capital Markets makes no representation or warranty, express or implied, in respect thereof, takes no responsibility for any errors and omissions contained herein and accepts no liability whatsoever for any loss arising from any use of, or reliance on, this report or its contents. Information may be available to BMO Capital Markets or its affiliates that is not reflected in this report. The information in this report is not intended to be used as the primary basis of investment decisions, and because of individual client objectives, should not be construed as advice designed to meet the particular investment needs of any investor. This document is not to be construed as an offer to sell, a solicitation for or an offer to buy, any products or services referenced herein (including, without limitation, any commodities, securities or other financial instruments), nor shall such Information be considered as investment advice or as a recommendation to enter into any transaction. Each investor should consider obtaining independent advice before making any financial decisions. This document is provided for general information only and does not take into account any investor's particular needs, financial status or investment objectives. BMO Capital Markets or its affiliates will buy from or sell to customers the securities of issuers mentioned in this report on a principal basis. BMO Capital Markets or its affiliates, officers, directors or employees have a long or short position in many of the securities discussed herein, related securities or in options, futures or other derivative instruments based thereon. The reader should assume that BMO Capital Markets or its affiliates may have a conflict of interest and should not rely solely on this report in evaluating whether or not to buy or sell securities of issuers discussed herein.

Dissemination of Economic Publications

Our publications are disseminated via email and may also be available via our web site https://economics.bmo.com. Please contact your BMO Financial Group Representative for more information.

Additional Matters

This report is directed only at entities or persons in jurisdictions or countries where access to and use of the information is not contrary to local laws or regulations. Its contents have not been reviewed by any regulatory authority. BMO Capital Markets does not represent that this report may be lawfully distributed or that any financial products may be lawfully offered or dealt with, in compliance with regulatory requirements in other jurisdictions, or pursuant to an exemption available thereunder.

To Australian residents: BMO Capital Markets Limited is exempt from the requirement to hold an Australian financial services licence under the Corporations Act and is regulated by the UK Financial Conduct Authority under UK laws, which differ from Australian laws. This document is only intended for wholesale clients (as defined in the Corporations Act 2001) and Eligible Counterparties or Professional Clients (as defined in Annex II to MiFID II).

To Canadian Residents: BMO Nesbitt Burns Inc. furnishes this report to Canadian residents and accepts responsibility for the contents herein subject to the terms set out above. Any Canadian person wishing to effect transactions in any of the securities included in this report should do so through BMO Nesbitt Burns Inc.

To U.K./E.U. Residents: In the UK, Bank of Montreal London Branch is authorised and regulated by the Prudential Regulation Authority and the Financial Conduct Authority ("FCA") and BMO Capital Markets Limited is authorised and regulated by the FCA. The contents hereof are intended solely for clients which satisfy the criteria for classification as either a "professional client" or an "eligible counterparty", each as defined in Directive 2014/65/EU ("MiFID II"). Any U.K. person wishing to effect transactions in any security discussed herein should do so through Bank of Montreal, London Branch or BMO Capital Markets Limited; any person in the E.U. wishing to effect transactions in any security discussed herein should do so through BMO Capital Markets Limited. In the UK this document is published by BMO Capital Markets Limited which is authorised and regulated by the Financial Conduct Authority. The contents hereof are intended solely for the use of, and may only be issued or passed on to, (I) persons who have professional experience in matters relating to investments falling within Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (the "Order") or (II) high net worth entities falling within Article 49(2)(a) to (d) of the Order (all such persons together referred to as "relevant persons"). The contents hereof are not intended for the use of and may not be issued or passed on to retail clients.In an E.U. Member State this document is issued and distributed by Bank of Montreal Europe plc which is authorised and regulated in Ireland and operates in the E.U. on a passported basis. This document is only intended for Eligible Counterparties or Professional Clients, as defined in Annex II to "Markets in Financial Instruments Directive" 2014/65/EU ("MiFID II").

To Hong Kong Residents: This document is issued and distributed in Hong Kong by Bank of Montreal ("BMO"). BMO is an authorized institution under the Banking Ordinance (Chapter 155 of the Laws of Hong Kong) and a registered institution with the Securities and Futures Commission (CE No. AAK809) under the Securities and Futures Ordinance (Chapter 571 of the Laws of Hong Kong). This material has not been reviewed or approved by any regulatory authority in Hong Kong. Accordingly the material must not be issued, circulated or distributed in Hong Kong other than (1) except for "structured products" as defined in the Securities and Futures Ordinance, in circumstances which do not constitute it as a "Prospectus" as defined in the Companies Ordinance or which do not constitute an offer to the public within the meaning of that Ordinance, or (2) to Professional investors as defined in the Securities and Futures Ordinance and the Securities and Futures (Professional Investor) Rules made thereunder. Unless permitted by the securities laws of Hong Kong, no person may issue in Hong Kong, or have in its possession for issue in Hong Kong this material or any other advertisement, invitation or document relating to the products other than to a professional investor as defined the Securities and Futures Ordinance and the Securities and Futures (Professional Investor) Rules.

To Korean Residents: This material is not provided to make a recommendation for specific Korean residents to enter into a contract for trading financial investment instruments, for investment advising, for discretionary investment, or for a trust, nor does it constitute advertisement of any financial business or financial investment instruments towards Korean residents. The material is not provided as advice on the value of financial investment instruments or any investment decision for specific Korean residents. The provision of the material does not constitute engaging in the foreign exchange business or foreign exchange brokerage business regulated under the Foreign Exchange Transactions Act of Korea.

To PRC Residents: This material does not constitute an offer to sell or the solicitation of an offer to buy any financial products in the People's Republic of China (excluding Hong Kong, Macau and Taiwan, the "PRC"). BMO and its affiliates do not represent that this material may be lawfully distributed, or that any financial products may be lawfully offered, in compliance with any applicable registration or other requirements in the PRC, or pursuant to an exemption available thereunder, or assume any responsibility for facilitating any such distribution or offering. This material may not be distributed or published in the PRC, except under circumstances that will result in compliance with any applicable laws and regulations.

Singapore Residents: This document has not been registered as a prospectus with the Monetary Authority of Singapore and the material does not constitute an offer or sale, solicitation or invitation for subscription or purchase of any shares or financial products in Singapore. Accordingly, BMO and its affiliates do not represent that this document and any other materials produced in connection therewith may lawfully be circulated or distributed, whether directly or indirectly, to persons in Singapore. This document and the material do not and are not intended to constitute the provision of financial advisory services, whether directly or indirectly, to persons in Singapore. This document and any information contained in this report shall not be disclosed to any other person. If you are not an accredited investor, please disregard this report. BMO Singapore Branch does not accept legal responsibility for the contents of the report. In Asia, Bank of Montreal is licensed to conduct banking and financial services in Hong Kong and Singapore. Certain products and services referred to in this document are designed specifically for certain categories of investors in a number of different countries and regions. Such products and services would only be offered to these investors in those countries and regions in accordance with applicable laws and regulations. The Information is directed only at persons in jurisdictions where access to and use of such information is lawful.

To Thai Residents: The contents hereof are intended solely for the use of persons qualified as Institutional Investors according to Notification of the Securities and Exchange Commission No. GorKor. 11/2547 Re: Characteristics of Advice which are not deemed as Conducting Derivatives Advisory Services dated 23 January 2004 (as amended). BMO and its affiliates do not represent that the material may be lawfully distributed, or that any financial products may be lawfully offered, in compliance with any regulatory requirements in Thailand, or pursuant to an exemption available under any applicable laws and regulations.

To U.S. Residents: BMO Capital Markets Corp. furnishes this report to U.S. residents and accepts responsibility for the contents herein, except to the extent that it refers to securities of Bank of Montreal.

These documents are provided to you on the express understanding that they must be held in complete confidence and not republished, retransmitted, distributed, disclosed, or otherwise made available, in whole or in part, directly or indirectly, in hard or soft copy, through any means, to any person, except with the prior written consent of BMO Capital Markets.

ADDITIONAL INFORMATION IS AVAILABLE UPON REQUEST

BMO Financial Group (NYSE, TSX: BMO) is an integrated financial services provider offering a range of retail banking, wealth management, and investment and corporate banking products. BMO serves Canadian retail clients through BMO Bank of Montreal and BMO Nesbitt Burns. In the United States, personal and commercial banking clients are served by BMO Harris Bank N.A., (Member FDIC). Investment and corporate banking services are provided in Canada and the US through BMO Capital Markets.

BMO Capital Markets is a trade name used by BMO Financial Group for the wholesale banking businesses of Bank of Montreal, BMO Harris Bank N.A, (Member FDIC), Bank of Montreal Europe Plc, and Bank of Montreal (China) Co. Ltd. and the institutional broker dealer businesses of BMO Capital Markets Corp. (Member FINRA and SIPC) in the U.S., BMO Nesbitt Burns Inc. (Member Canadian Investor Protection Fund) in Canada, Europe and Asia, Bank of Montreal Europe Plc in Europe, BMO Capital Markets Limited in the U.K. and Australia and BMO Advisors Private Limited in India.