ECONOMIC RESEARCH AND STRATEGY

LAURENTIAN BANK SECURITIES

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North American Labour Market Reports and Recession Indicators Dashboard

U.S. NFP Report: The U.S. NFP report released this morning shows labour market resilience. The net addition of 372K jobs in June is weaker than the 500K+ monthly pace observed in early 2022 and late 2021 but in line with the 3-month moving average of 383K. The unemployment rate stayed at a very low 3.6% for a third month in a row. Labour market dynamics remain healthy, echoed by the third consecutive monthly decline in the number of job losers. One sign of softness relates to new hires, down in June relative to previous months. Put simply, most companies challenged by margin compressions, wage inflation and a weaker sales outlook privilege hiring freeze over layoffs. Growth in average hourly earnings stay in the fast lane (0.5% m-o-m, 6.4% y-o-y). In another report released earlier this week, markets learnt that the number of job postings declined swiftly in April and May. Job postings, a better determinant of wage inflation than unemployment according to several studies, reinforces the idea that the peak in wage inflation is coming sooner rather than later.

This morning's resilient US NFP numbers will mostly reassure those in the non-recession camp. One of our recession indicators is the "Sahm rule". The Sahm rule stipulates an increase north of 0.5pp in the 3-month moving average of the unemployment rate relative to its low in the preceding 12 months is an extremely good indicator a recession in the coming months. This metric stood at -0.2pp last winter, -0.1pp last spring and 0.0pp in June. This trend is unambiguously unfriendly, although the 0.0pp figure remains comfortably distant from the 0.5pp+ critical threshold. Another job market indicator on our recession dashboard is the Kansas City Fed labour market indicator (LMI). Both momentum and level of the KC LMI have been softening but remain positive according to the latest May reading. We expect momentum of the KC LMI to move very close to zero in June. When momentum falls in negative territory, it historically leads a US real GDP contraction by a few months or quarters.

All in all, positive net job creation contrasts with the Atlanta Federal Reserve real GDP nowcast latest release showing a -2.1% contraction during 2022Q2 versus the previous quarter. Initial US real GDP prints and revisions published by the Bureau of Economic Analysis historically tend to be positive versus the nowcast figures, preventing a vast majority of investors to think the U.S. is entering a technical recession. Recession models of UCSD economics professor James Hamilton peg the odds of a recession between 4% and 22% one year from now. The odds appear on the low side considering his models are based on financial spreads and oil but not other pricy CPI items choking consumers. In contrast, the latest estimate of the Bloomberg recession model pegs chances of a US recession at 38%.

Canadian LFS – At this stage of the business cycle, what matters first is consumer behaviour, then companies' behaviour relative to staff levels. The BoC 2022Q2 consumer survey released last Monday raises concerns, echoing US consumer sentiment indicators sitting at recession levels. Indeed, a large share of Canadians cut back on spending lately and plan to reduce purchases further due to high inflation depressing real wages and high interest rates increasing debt servicing. It turns out the disappointing 43K m-o-m decline in total Canadian employment for the month of June comes from weakness in consumer staples and discretionary spending. Indeed, employment in wholesale and retail industry (-60K m-o-m), information, culture and recreation (-14K m-o-m) and accommodation and food (-11K m-o-m) declined, reflecting the precautionary mindset of consumers. Many of the losses were tied to self-employed occupations, concentrated in the age cohort 55 years old and over. Average hourly wages of $31.54 stands 5.2% above last year's level. According to the BoC 2022Q2 business outlook survey released last Monday, companies expect wages to increase by 5.8%, on average, during the next 12 months. Given the positive momentum in wages, the large 0.8pp drop in the labour participation rate to 64.9% observed in June disappoints. The participation rate is suddenly back below 65% for the first time since the spring of 2021. This surprising decline appears voluntary and broad-based across age cohorts and sectors. All in all, we attribute about two-thirds of the decline in the unemployment rate (from 5.1% in May to 4.9% in June) to the fall in the labour force and the remaining one-third to the drop in the number of unemployed Canadians. The Sahm rule figure for Canada also stands at zero like the United States.

At the provincial level, a few segments of Quebec's job market have been underperforming lately. Led by a decline in full-time positions, total employment in Quebec fell by a cumulative 48K or 1% relative to three months ago. Quebec's unemployment rate edged up from the April trough of 3.9% to a still very low 4.3% figure in June. On the positive side, growth in average hourly earnings in Quebec (+7.8% y-o-y) largely all other Canadian provinces. Ontario registered its first setback in total job creation (-25K m-o-m) since the Omicron wave of last January due to a pullback in part-time jobs. Meanwhile, the very positive momentum observed in Alberta continues. Total employment was up for the eight consecutive month in June, bringing y-o-y gains to an amazingly solid 6.6%. Alberta's unemployment rate of 4.9% now sit below Ontario (5.1%) for the first time since 2015. Other energy-rich provinces Saskatchewan and N&L are registering solid gains, although to a lesser extent than Alberta. Finally, BC remains a slight outperformer with an unemployment rate figure of 4.6%.

Solid hiring intentions highlighted by the BoC 2022Q2 business outlook survey support further resilience going forward. On the positive side, the large - but declining - number of unfilled positions could lead companies to retain or reshuffle staff in their organization even if economic momentum weakens further, preventing major financial stress. On the negative side, if respondents of the BoC 2022Q2 consumer survey materialize their intentions, consumer spending in real terms could drop by about 2% over the next 12 months. Such as precautionary behaviour would bring Canada closer to recession territory and push companies to consider job cuts.

Bottom Line: 5%+ wage growth and unemployment below 5% support market pricing of a 75bps BoC policy rate hike next Wednesday, on top of the extremely elevated inflation expectations highlighted in the BoC consumer survey. The BoC policy rate poised to increase swiftly from 1.50% to 2.25% will contribute to break down the current inflation psychology. Warnings from vocal BoC officials that interest rates will go up, on top of implementing incremental policy rate hikes bigger than 25bps, have notably changed the perception of homebuyers. Real estate boards of Montreal, Toronto and Vancouver all reported this week a continuous drop in home sales and average prices for the month of June. The hawkish words of central bankers led broad financial conditions, as reported by the Chicago Fed Financial Conditions Index, to become relatively more restrictive than the current level of the Federal Reserve and BoC policy rates. Accordingly, central banks could end up with a peak terminal rate lower than currently priced in by markets as signs of cooling in the real economy increase. This market view could become more popular in Canada than in the U.S., based on the relative softness of the June job report, higher housing-to-GDP ratio and higher household debt-to-GDP ratio.

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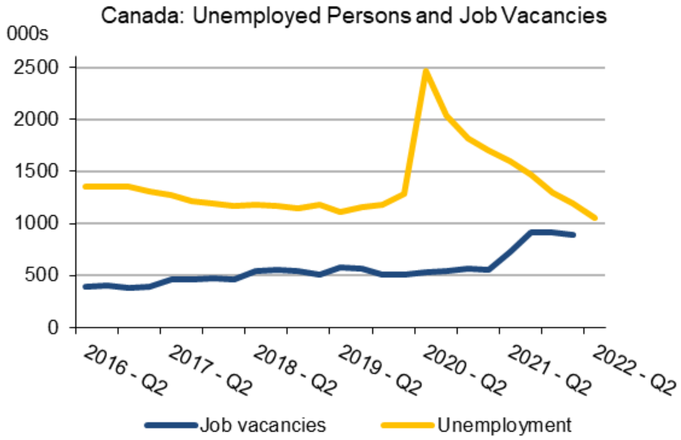
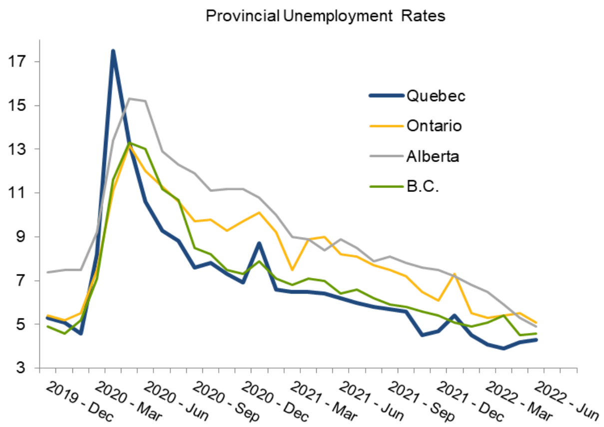
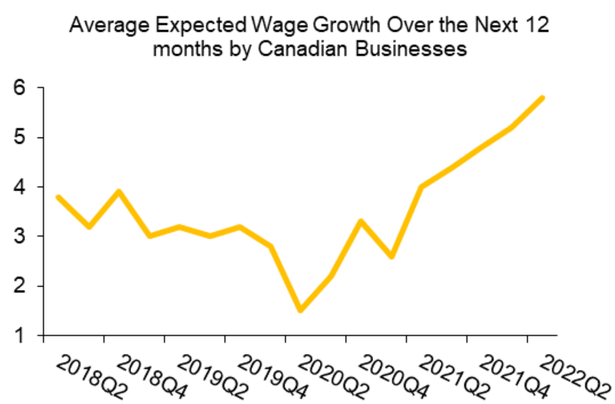


Source: Statistics Canada, LBS Econ. Research and Strategy.



Source: Statistics Canada



Source: Bank of Canada Business Outlook Survey