Sébastien Lavoie,
Chief Economist
LavoieS@vmbl.ca
514 350-2931

Dominique Lapointe, CFA,
Senior Economist
LapointeD@vmbl.ca
514 350-2924

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Canada Blockbuster Jobs Report (Feb) / Russian Invasion of Ukraine Clouds the Economic Outlook

Coinciding with the gradual lifting of economic restrictions in February, Canadian employment rebounded by 337K m/m (+1.8%), more than erasing the 200K net loss from January. Net job creation came in significantly above the +160K consensus and our +210K forecast, highlighting tight labour market conditions and stronger-than-expected economic momentum at the beginning of 2022. However, the Russian invasion of Ukraine and the resulting sanctions cause tremendous financial market volatility and economic uncertainty. Canada is not immune to the war raging in Europe. As such, we provide some context on its possible economic impact in the second section of this report.

Positive everywhere you look

This morning's labour force survey revealed positive developments across most segments of the jobs market. First, the majority of the gains occurred in part-time employment and in industries directly affected by Omicron-related shutdowns in December and January. For instance, employment rebounded sharply in food and accommodation services, information, culture and recreation and in retail trade. All provinces registered positive employment growth last month, with the largest gains in Ontario and Quebec. In fact, except New Brunswick, all provinces have now recovered the level of employment that prevailed prior to the pandemic (Table 1). Second, services industries that performed well throughout the pandemic due to the possibility to work from home and adaptability continued to do so last month. Employment strongly increased in professional and technical, and financial services. Also, record-high residential units under construction and a recent rebound in non-residential investment boosted employment in the construction industry for a third consecutive month.

More broadly, several labour indicators reflecting the degree of economic slack suggested that the labour market operated at full capacity last month. The unemployment rate for youth aged 15-24 declined to 10.8%, virtually the same as its pre-pandemic level. Long-term unemployment of 27 weeks or more declined another 51K and is now close to full recovery. Despite an increase in the labour force participation rate, the unemployment rate declined a full percentage point to 5.5% in February, below the 5.6% level that prevailed in January 2020. Finally, Statistics Canada's labour force underutilization rate, which includes people who worked half their usual hours and people not in the labour force but would want to work, is now consistent with "full employment" (chart 1).

The Bank of Canada continues to have the green light to hike interest rates

The state of the labour market in February as well as overall economic conditions and inflationary pressures strongly favour at least three additional rate hikes in 2022 by the Bank of Canada, in April and in June to begin with. However, this does not account for the material impact that the war in Europe will have on global inflationary pressure and economic activity.

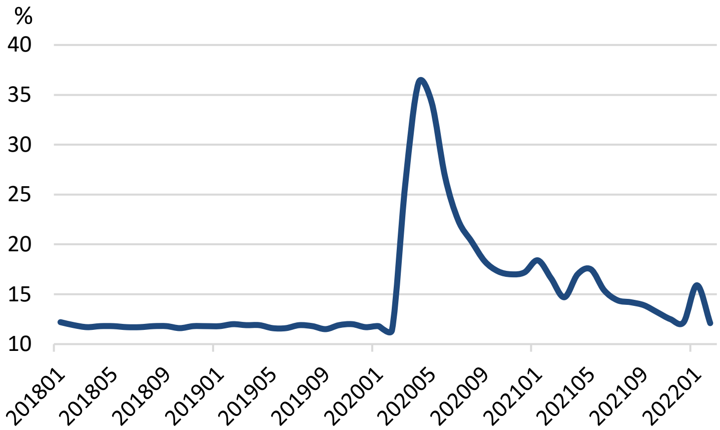
Table 1: Labour Force Survey

	Employment (Feb. 2020 = 100)	Unemployment Rate (%)
BC	103.2	4.9
ON	102.6	5.5
PE	102.6	9.0
NL	102.2	12.3
NS	102.1	6.6
Canada	**101.9**	**5.5**
AB	101.8	6.8
SA	101.4	4.7
MB	101.1	4.8
QC	100.5	4.5
NB	99.2	7.9

Note: as of Feb. 2022

Source: Statistics Canada

Chart 1: Canada Labour underutilization rate



Note: Last data point is February 2022
Source: Statistics Canada.

Economic Update - Beyond the human tragedy, the Russian invasion of Ukraine generates significant uncertainty to the economic and financial outlook. The impact of the multiple sanctions imposed on the Russian economy will be felt through several transmission channels: the compounded effect of higher commodity prices on inflation and the hit to the real economy, sanctions and war measures disrupting normal trade activity and commercial routes, capital destruction and uncertainty weighing down on business and consumer confidence. Thus, there are multiple and diverging paths surrounding our January economic and financial forecasts.

Before the distortionary impact of the war, the Canadian economy was already running at full capacity. Inflationary pressure from the war could therefore feed into a faster wage growth environment and bring additional costs in the global supply chain. The risk of inflation expectations de-anchoring is real and is already showing up in widely followed market-based measures such as the 10-year U.S. breakeven rate and the 5-year/5-year forward swap rate. In the near term, it is also imperative to monitor a severe deterioration in financial conditions. We currently forecast Canadian CPI inflation to reach 6.0% in March and time will tell if this turns out to be the peak or not. A broader conflict beyond the current Russia-Ukraine war could be devastating for the global economy. Research demonstrates that large wars lead to high inflation and higher bond yields. Thus, central bankers will have to adapt. On a brighter note, a positive global economic momentum in early 2022, elevated household excess savings and a lower oil intensity in global GDP are valuable offsets in 2022 that us prevent for now to forecast an outright global recession. Also, financial assistance from all levels of government could ease the inflation pain for certain households facing a severe deterioration in their purchasing power.

Ultimately, the duration of the Ukraine war/sanctions and the wide range of positive and negative geopolitical developments will determine to what extent it stifles global and Canadian real GDP growth. We are currently revisiting our base case and alternative scenarios. Yesterday, the ECB published new economic forecasts. In their base case scenario, the ECB revised down its Euro Area real GDP growth forecast by half a percentage point in 2022 (from 4.2% to 3.7%) and boosted its 2022 average CPI inflation forecast almost 2 percentage points (from 3.2% to 5.1%). The ECB recognizes the risk of more significant damage tied to the war by presenting two alternative, pessimistic scenarios. In those, the ECB pencils in 2022 Euro Area real GDP growth between 2.0% and 2.5% and 2022 CPI inflation between 6% and 7%.

Sébastien Lavoie | Chief Economist
514 213-4571 | lavoies@vmbl.ca

Dominique Lapointe, CFA | Senior Economist
514 350-2924 | lapointed@vmbl.ca