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EXECUTIVE SUMMARY

Inflation Concerns Grow Greater

In the face of the COVID-19 pandemic and the Russian invasion of Ukraine, inflation has continued to persist at levels above the targeted 2% annual rate. The 2% target is flexible, of course, allowing for periods of higher-than-normal inflation in transitory periods of exogenous shocks to either supply or demand, however as time continues to pass with higher-than-normal inflation, inflationary expectations do become a cause for concern. If expectations are that high inflation will persist in more than a temporary basis, expectations will become reality.

Commented [CY2]: Suggestion: Use exact current inflation numbers and for how long has inflation exceeded the 1%-3% band.

Economy Out-Performs Expectations Post-Omicron Wave

337,000 jobs were added to the economy in February 2022, alongside a seasonally adjusted unemployment rate of 5.5%,[1] marking the lowest rate of the pandemic, even lower than the 5.7% figure recorded in February 2020, prior to the onset of the COVID-19 pandemic.

The Global Supply Chain Grows Increasingly Volatile

The global supply chain has been a source of price-inflation since the imposition of pandemic related restrictions, adding new barriers to global trade in our increasingly inter-dependent global economic landscape. With the recent Russian invasion of Ukraine, the global supply chain has been greatly disrupted with the imposition of economic sanctions upon Russian goods, having the most profound impact on international oil & food commodity prices.

Commented [CY3]: Cost-push ?

Commented [CY4]: How impactful is this for Canada? Or we are somehow shielded from this shock?

Policy Recommendation

The Bank of Canada should begin raising interest rates steadily, in line with contractionary monetary theory, to reduce the demand for money in a manner that does not risk shocking the economy and inducing unjust harm upon the working class.

Commented [CY5]: By how much and for how long? You will need to flesh out the implication of the policy recommendation later in the report.

Commented [CY6]: Suggestion: reducing/taming inflation pressures

[1] Statistics Canada, Labour Force Survey, February 2022. Retrieved March 12, 2022.

CANADIAN PRODUCTIVE OVERVIEW

Canada's Gross Domestic Product has fluctuated substantially since the onset of the COVID-19 pandemic in the first Quarter of 2020. The economy initially recessed significantly to a peak of 10% reduction in GDP in the second quarter of 2020, stemming from the pandemic's shocks to consumer spending and consumer employment.

Canada's federal government began to employ government policy to stimulate the economy by the summer of 2020, driving economic activity back to near pre-pandemic levels from its brief COVID-19 recession levels. The Bank of Canada followed suit, dropping the policy interest rate as low as 0.25%, to reduce the negative shock to investment.

Commented [CY7]: Investment only or the economy as a whole?

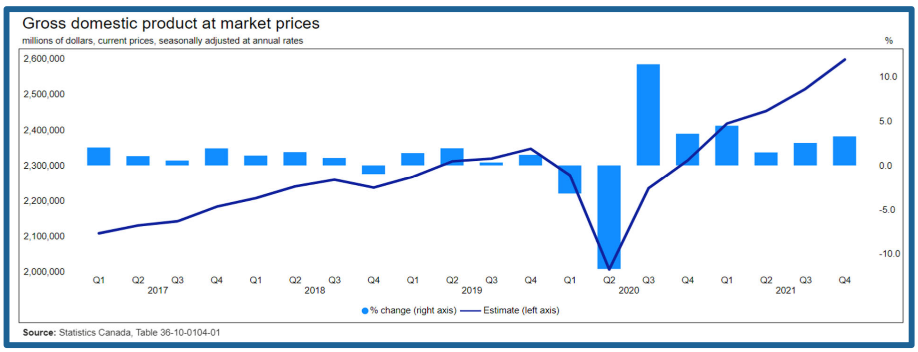


Chart 1: Gross Domestic Product at Market Prices (Statistics Canada)[2]

Statistics Canada's latest report released on March 1st, 2022, revealed that the 4.6% growth in 2021 after the 2020 decline of -5.2% was driven from growth in two major sectors: Business investment, and consumer spending.[3]

Business Investment

Business investment grew substantially in 2021, specifically in engineering structures and home ownership transfer costs which accounted for +3.5% and +14.3% respectively. Manufacturers and wholesaler's accumulation of non-farm non-durable goods (+$11.0 billion) accounted for the

[2] Statistics Canada, Gross domestic product by income and expenditure: Interactive tool. Retrieved March 12, 2022.
[3] Statistics Canada, Gross domestic product, income and expenditure, fourth quarter 2021. Retrieved March 12, 2022

majority of growth in the fourth quarter of 2021 as production prepares to accelerate. The economy-wide stock-to-sales ratio of non-farm inventory was stable at 0.829 which is slightly below the 0.842 average for 2018 and 2019.

Consumer Spending

On the consumer side, household spending dramatically increased in 2021 reflecting the re-opening of retail businesses and the economy. Additionally, the impacts of working from home and less travel with low mortgage rates spurred higher spending on housing. New home construction and renovations saw near-record level increases in 2021. Consequently, household mortgage debt was up 10.3% representing a record breaking $182.4 billion.

Commented [CY8]: Is this good or bad for the economy?

Government Expenditure

Even though government revenues grew 11.4% in 2021 compared to a 2.2% decrease in 2020, government expenditures decreased by 1.9% in 2021. This reflects the easing of support programs such as the Canada Emergency Recovery Benefit and others which contributed to the 23.8% increase in government expenditures in 2020 as a response to the pandemic.

INFLATION AND WORLD ECONOMICS

Consumer Price Index Inflation Remains Above Target Range

Measure of core inflation based on a weighted median approach, CPI-median (year-over-year percent change) shows inflation climbing over the targeted 2% annual rate from March 2021 through to January 2022 where it reached 3.3%.[4] The inflation target of 2% annually is a flexible target, of course, however with persistently out-of-range inflation levels the risk of increasing expected inflation arises, which can be a pathway to making temporary inflation become permanent.

Commented [CY9]: You should also use headline inflation numbers which are more dramatic to make your point. Also try to find best projections for the path of inflation in the next quarters.

Russian Invasion of Ukraine

On February 24, 2022, Russia announced a 'special military operation' in Ukraine to enforce peacekeeping after the expiration of the 2014 Minsk agreements. As a result, western nations have imposed sanctions on Russia in retaliation. This has caused global oil markets to skyrocket to record highs since Russia is one of the largest suppliers of the world's crude oil. Economists expect this to be short term as reserves will be released and production of crude increased. Canada will see increased demand from the US after they banned Russian crude oil. The EU is in a tougher position as they heavily rely on Russian oil and gas which poses a threat to European Energy Security.

Commented [CY10]: So a positive shock for Canada?

Implications on Canadian Inflation and Monetary Policy

Supply chain disruptions and higher energy costs have led to the cost push inflation that has been the trend since the COVID19 pandemic lockdown restrictions. Increased geopolitical tensions continue to exacerbate the worrying alarm bell of rising inflation globally. Russia is a Major exporter of Crude oil to the world. The sanctions placed upon these exports have major implications for inflation. Increased inflation rates by the west means it will be harder for developing nations to repay loans and may destabilize their economies.

The Bank of Canada recently raised its target overnight interest rate to 0.5% from 0.25% to address inflation.[5]

[4] Statistics Canada, Consumer Price Index statistics, measures of core inflation and other related statistics. Retrieved March 11, 2022.

[5] Bank of Canada, Bank of Canada increases policy interest rate, March 2, 2022.

LABOUR MARKET

Unemployment reaches a new post-COVID-19 low

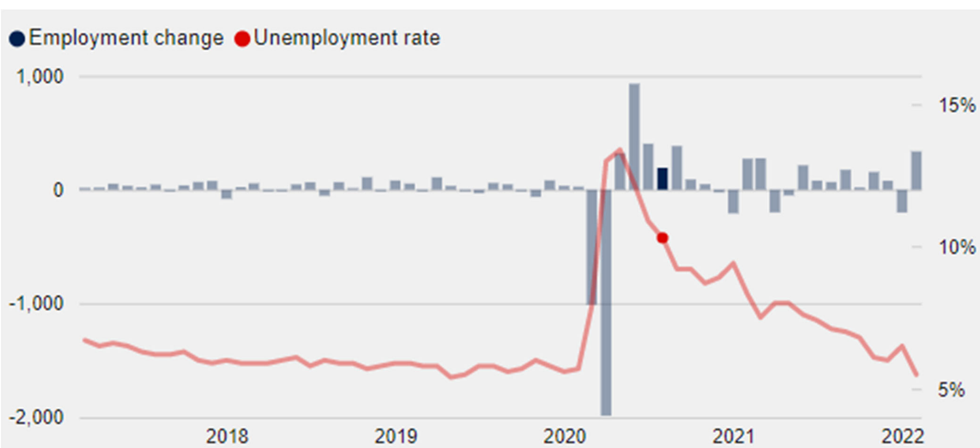
Employment levels in Canada as of February 2022 state that the unemployment rate is 5.5% which is 0.2% lower compared to February 2020. The record low for the Canadian unemployment rate sits at 5.4% in May 2019.[6] One reason for the decline in unemployment rate is from private sectors and was caused by nationwide increased demand for accommodation and food services, such as restaurants, as well as entertainment and recreation.

Labour Force Participation Rates Continue to Grow

Labor force participation rates have returned to pre pandemic levels for most of the age groups within the labour market. Businesses are faced with scarce demand exposure as 40% of businesses explained they are short on labour and are unable to meet the demands of the economy and expect to continue to see this going into 2023. As the economy continues to open there are a great deal of job openings and people can find jobs easily with higher pay incentives to boost motivation.[7]

Commented [CY11]: So why do you think the Bank has been so cautious in raising rates?

Chart 2: Unemployment rate and monthly employment change (in thousands)[8]



[6] Labour Force Survey, February 2022.
[7] Monetary policy report - January 2022. Bank of Canada. (n.d.). Retrieved March 12, 2022
[8] Statistics Canada, Labour Force Survey in brief: Interactive App. Retrieved March 13, 2022

Skill-Matching, Increased Wages Key to Improving Labour Force

Commented [CY12]: Although this might be true, it is outside the scope of monetary policy. Suggestion: delete this subsection.

The Canadian labour market is continuing to grow; however, it is still faced with shortages and skill matching problems. To help with labour shortages there are three strategies that can be most effective to improve future labour markets. Investing in technology and automation, using formal hiring processes, and providing a comprehensive compensation package. Investing in technology and automation is most effective and efficient for businesses. Using automation allows for workers time to be dedicated to "value added tasks".[9] A formal hiring process helps to create an organized strategic plan for hiring employees. In 2021, compensation was 9.1% higher than in 2020 which came from a combination of services, finance, real estate, and construction. Compensation is a useful preservation tool that focuses on salary and benefits, flexibility in the job and mentoring. As of February 2022, the employment has climbed 1.8% and the current year over year wage growth is 3.1%.[10]

[9] Cleroux, P., "2022 Economic Outlook for Canada," (2021, December 14) BDC.caBDC.ca
[10] Labour Force Survey, February 2022

POLICY RECOMMENDATION

Inflation Should Be Addressed with Responsible Monetary Policy

To adequately address concerns of inflation, the Bank of Canada has control over interest rates as its most efficacious policy tool. The Bank of Canada must be very cautious about raising interest rates for a plurality of reasons.

Commented [CY13]: See earlier comments about this point.

Contractionary Theory To 'Cool' a 'Hot' Economy

To slow growth in prices, conventional economic theory would prescribe contractionary policies. These macroeconomic tools seek to reduce the rate of growth in the money supply by reducing the rate of demand for money so that the new equilibrium level of money in the economy is lower, reducing price inflation.[11]

Commented [CY14]: This is the same point so it can be merged with the paragraph above. In terms of MP tactics, we will learn that the Bank uses the overnight interest rate as the key policy instrument, rather than the money supply.

Alternative Perspectives to Bank of Canada Policy Measures

Contrary to conventional economic thought, post-Keynesian economists such as Thomas Palley argue in favor of the endogenous money theory, that largely dismisses interest rates as a factor in money supply and instead sees interest rates as an ineffective tool of monetary policy.[12] Contrarily, Marxist economists would make the class conflict argument that frames interest rates as an effective policy tool for reducing the collective bargaining power of the working people, by increasing the unemployment rate. Of course, inflation is harmful for everyone, and interest rates should certainly be raised, given the proper context, although there is value in acknowledging the potentially harmful role that poor monetary policy can employ upon an economy.

Commented [CY15]: Interesting point but I expected you would suggest an actual alternative policy fully fleshed out for consideration.

Raise Rates Slowly to Decrease Demand for Money Without Shocking Growth and Labour

There has yet to be adequate evidence to draw the conclusion that the high inflation felt over the pandemic will require stagflation-era policy measures with significantly high interest rates to be appeased. A heavy-handed approach with rapid rate increases would appear foolish, given that

[11] Contractionary Policy, Investopedia.com, Retreived 2022-03-14
[12] Palley, T. Endogenous Policy: What It Is and Why It Matters, November 2001.

unlike the 1970s, we are not experiencing stagflation. The economy is growing steadily, and the labour market has finally re-stabilized in the wake of COVID-19.

To properly address inflation, the Bank of Canada should continue to steadily increase interest rates to reduce the demand for money and restore confidence to reduce expectations of inflation. This must be done steadily and not abruptly so that average Canadians are not negatively affected by increased mortgage payments in an already problematic housing market.

Commented [CY16]: Is money demand really the underlying problem that higher interest rates are trying to address? Revise this paragraph.
What is your recommendation as to the size and pace of interest rate raises?

** Will determine exact recommended figures for final policy report. **

Commented [CY17]: