



The Bottom Line

THE LATEST VIEW ON THE ECONOMY



ECONOMIC
RESEARCH

BMO  Capital Markets[®]

July 2, 2009

Dr. Sherry Cooper
Executive Vice
President,
Chief Economist

1-800-613-0205

Those who have been calling for a Fed exit strategy from the extraordinary degree of monetary ease should be silenced by the June employment results. The U.S. economy is still far too weak for the Fed to be worried about inflation. The larger-than-expected payroll decline is only part of the story. While the jobless rate rose to a 26-year high of 9.5%, even more telling is the jump in the broadest measure of unemployment, so-called U6, to 16.5% in June. This more comprehensive measure of labour underutilization accounts for discouraged workers (those who have stopped looking for jobs) and those who can't find full-time work. While there is some evidence that more workers have started looking for jobs again, the 16.5% figure is very troubling and might help to explain the decline in recent consumer confidence data.

The broader jobless rate is now at a record high, even looking back to a discontinued and broader calculation of the number available prior to 1994 (going back to the 1970s). For example, the broader measure hit 15% in late 1982, following Chairman Volcker's unprecedented monetary squeeze, when the official unemployment rate was 10.8%. The gap between the two indexes of unemployment has begun to narrow as the "green shoots" of an economic turnaround began to surface, encouraging labour-market dropouts back into the market. However, the number of long-term unemployed continues to rise—4.4 million people have been unemployed for more than 27 weeks, up from 3.9 million last month. The average duration of unemployment has hit a record-high 24.5 weeks, suggesting that most companies remain on the sidelines as far as hiring is concerned.

With this much excess capacity in the labour market, wage pressures continue to ease. Accordingly, inflation is very unlikely to develop on a sustained basis. Remember, commodity price increases do not spell inflation unless they spiral through the pricing structure encouraging increased wage demands. Commodity prices rose sharply through the first part of this decade while consumer inflation failed to rise. Aggregate hours worked continue to fall and average hourly wages continue to grind lower.

Bottom Line: Given the expected further contraction in the auto-employment sector, and only a modest revival in growth for the rest of this year, inflation fears are unfounded and the Fed will refrain from even hinting at monetary tightening. The fact is, the U.S. money supply growth has slowed meaningfully in recent weeks and the Fed's balance sheet has contracted. If anything, the Fed might inject more liquidity into the system in light of these continued poor job results.

The information, opinions, estimates, projections and other materials contained herein are provided as of the date hereof and are subject to change without notice. Some of the information, opinions, estimates, projections and other materials contained herein have been obtained from numerous sources and Bank of Montreal ("BMO") and its affiliates make every effort to ensure that the contents thereof have been compiled or derived from sources believed to be reliable and to contain information and opinions which are accurate and complete. However, neither BMO nor its affiliates have independently verified or make any representation or warranty, express or implied, in respect thereof, take no responsibility for any errors and omissions which may be contained herein or accept any liability whatsoever for any loss arising from any use of or reliance on the information, opinions, estimates, projections and other materials contained herein whether relied upon by the recipient or user or any other third party (including, without limitation, any customer of the recipient or user). Information may be available to BMO and/or its affiliates that is not reflected herein. The information, opinions, estimates, projections and other materials contained herein are 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, opinions, estimates, projections and other materials be considered as investment advice or as a recommendation to enter into any transaction. Additional information is available by contacting BMO or its relevant affiliate directly. BMO and/or its affiliates may make a market or deal as principal in the products (including, without limitation, any commodities, securities or other financial instruments) referenced herein. BMO, its affiliates, and/or their respective shareholders, directors, officers and/or employees may from time to time have long or short positions in any such products (including, without limitation, commodities, securities or other financial instruments). BMO Nesbitt Burns Inc. and/or BMO Capital Markets Corp., subsidiaries of BMO, may act as financial advisor and/or underwriter for certain of the corporations mentioned herein and may receive remuneration for same. "BMO Capital Markets" is a trade name used by the Bank of Montreal Investment Banking Group, which includes the wholesale/institutional arms of Bank of Montreal, BMO Nesbitt Burns Inc., BMO Nesbitt Burns Ltée/Ltd., BMO Capital Markets Corp. and Harris N. A., and BMO Capital Markets Limited. TO U. S. RESIDENTS: BMO Capital Markets Corp. and/or BMO Nesbitt Burns Securities Ltd., affiliates of BMO NB, furnish this report to U. S. residents and accept responsibility for the contents herein, except to the extent that it refers to securities of Bank of Montreal. Any U. S. person wishing to effect transactions in any security discussed herein should do so through BMO Capital Markets Corp. and/or BMO Nesbitt Burns Securities Ltd. TO U. K. RESIDENTS: The contents hereof are not directed at investors located in the U. K., other than persons described in Part VI of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2001.

TM - "BMO (M-bar roundel symbol) Capital Markets" is a trade-mark of Bank of Montreal, used under licence. © Copyright Bank of Montreal.