THE KWAMMENTARY

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ODLUM BROWN
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Stagflation – Santa's least favourite reindeer (part two)

♪ *Then one foggy Christmas Eve,*
Santa came to say,
"Staggy, you're a real mood kill
Won't you stay at home and chill?" ♪

In last month's note, I discussed some of the current concerns that are giving the markets pause and raising the prospect of a stagflated environment in 2022. Today, I will go over some thoughts on why we remain constructive on the outlook for 2022.

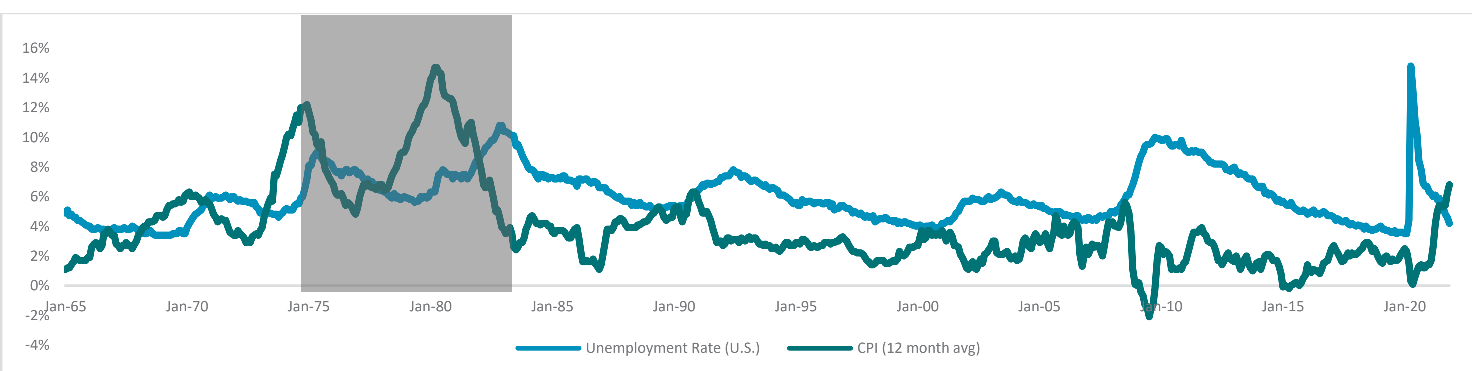
Labour Market

One of the dynamics in play during the last round of stagflation (shaded in graph below) was high inflation combined with high unemployment rates. A healthy economy requires people to be able to work and, as a by-product, spend. Not only were high prices keeping people away from spending, but fewer employment opportunities also kept wallets tight and high interest rates made debt-financed growth costly.

Contrast that with our current situation, and there are some key differences. Interest rates are significantly lower now than in the 1970s, there seems to be ample work for those looking (in fact, in some places there are labour shortages) and savings rates are higher than usual. With the exception of inflation, the variables that contributed to stagflation in the 70s are not as prevalent today.

Interest Rates

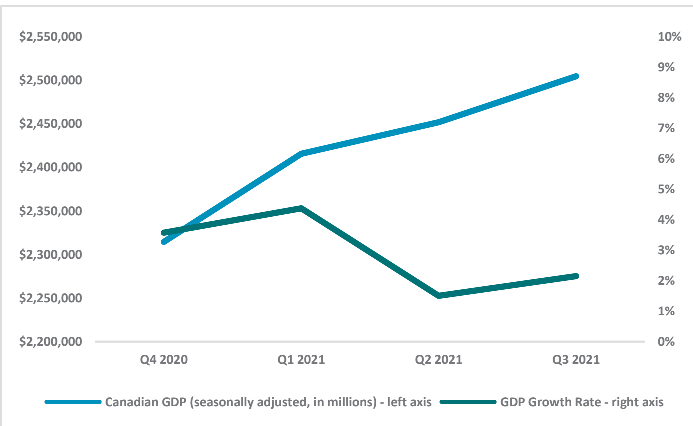
There were talks of potential interest rate hikes from various central bank officials that started out as whispers, and have only recently breached "outside voice" levels. This variable requires further monitoring, but initial consensus points towards rate hikes throughout 2022 (according to this [December U.S. Federal Reserve announcement](#)). This is not necessarily a bad thing, as some have argued that low interest rates have been low for too long. It remains to be seen how far these moves will go, but given



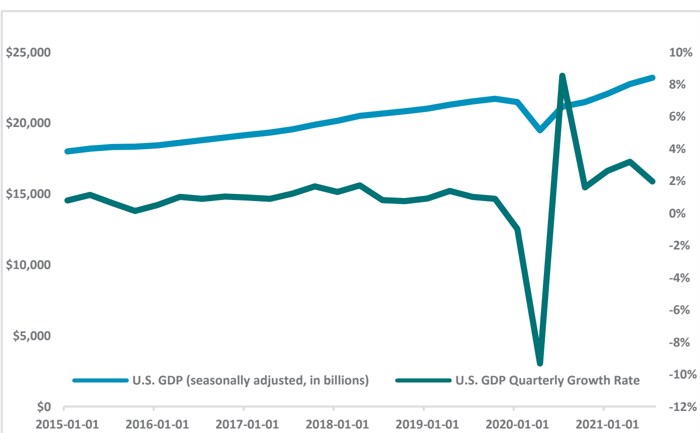
Source: U.S. Bureau of Labour Statistics and the Federal Reserve Economic Data (St. Louis FRED) the current suggested trajectory, it will be a while until we have reached rates that would cause serious pain. We will continue to monitor this closely.

GDP

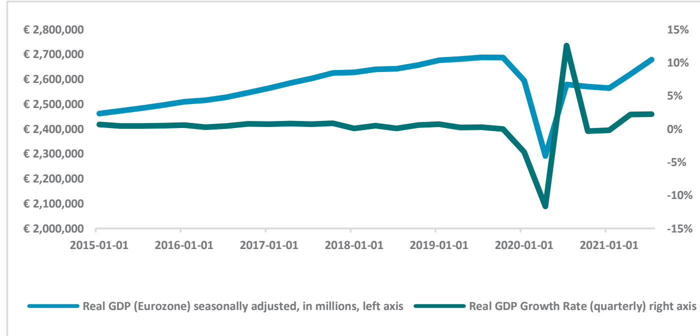
The charts below are self-explanatory; Gross Domestic Product (GDP) growth continues its upwards trajectory in the major developed countries, but has moderated in recent quarters. A portion of that can be attributed to math gimmickry, where previous quarterly growth was so robust coming off a significant contraction. By comparison, any growth afterwards would look moderate, although in the grand scheme of things, it could be considered normal in the proper context.



Source: Statistics Canada



Source: Federal Reserve Economic Data (St. Louis FRED)



Source: Federal Reserve Economic Data (St. Louis FRED)

It is worthwhile noting that GDP growth has been positive, in spite of large portions of the economy still being underutilized. Going forward (barring another significant lockdown), I believe the GDP picture continues to look positive, as more opportunities to spend and consume open up.

Trade Policy

I have some concerns about this topic. Goods or services experience varying levels of cross-border "friction" whenever they move from one place to another, and that friction has a cost. Certain policies increase friction (tariffs) or decrease it (free-trade zones), and those policies end up having a material impact on the prices we see at home. In North America, we have USMCA (United States-Mexico-Canada Agreement) and across the globe, other countries have a range of "understandings" that are built off World Trade Organization guidelines. Current trade issues are contentious worldwide, but particularly between the U.S. and China. How this unfolds will have some impact on inflation numbers, although to what extent is unclear.

Putting it all together – 2022 Outlook

It does not take an individual with their CFA charter to conclude that we still have many difficult problems to solve in 2022. The COVID-19 virus still looms, and with it, the uncertainty of when/how we get back to any semblance of normal. The knock-on effects are numerous, but what I have seen over the past two years has been largely reassuring. Businesses have been able to adapt to a situation in constant flux, and innovation in the health care space around the virus has grown at an unprecedented pace (side note: I cannot wait to never say "unprecedented" ever again!). Even in light of the new variant, the amount of foundational knowledge that has accumulated since 2020 puts us in a significantly better place than we were before. The odds are not as severely stacked against progress as they were before, and that makes me optimistic.

Speaking of optimism, I owe you all a large debt of gratitude. The past two years have been a challenging time, and your continued trust in me and the firm has made a considerable difference during so much anxiety and uncertainty. For that, I am extremely grateful to you.

With that, I wish you and your loved ones good health and a very happy holiday season. I look forward to chatting with you all in the New Year.

Sincerely,

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