From: Ermes Monaco <e.monaco@iaprivatewealth.ca>
Sent: October 15, 2021 12:48 PM
To: Ermes Monaco <e.monaco@iaprivatewealth.ca>
Subject: VALUED CLIENT MAIL LIST: Economic Outlook - Fall 2021
Importance: High

iA Private Wealth

MONACO
CAPITAL
MANAGEMENT

INFLATION:

NOW YOU

SEE ME

NOW YOU

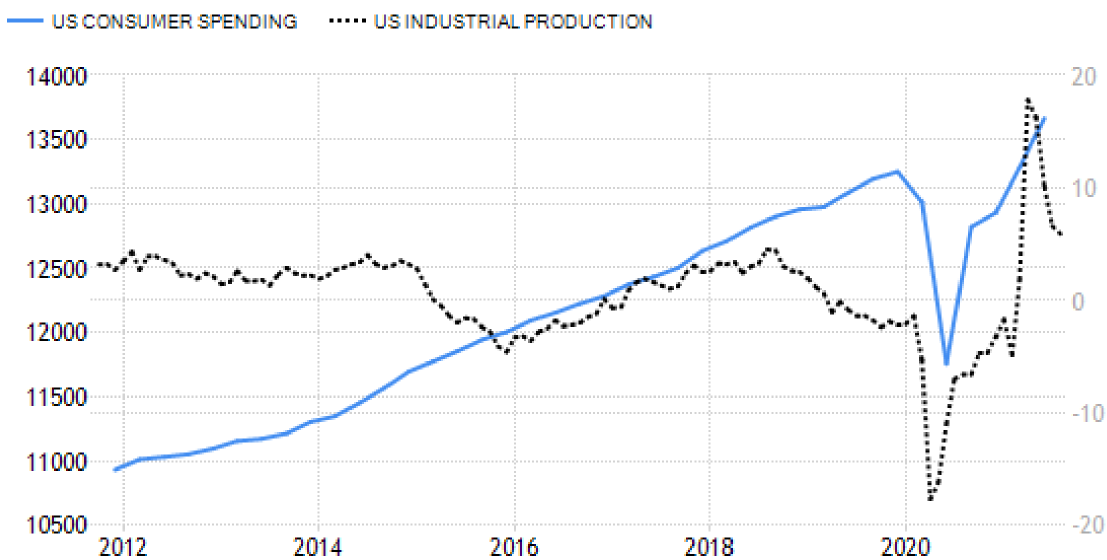
DON'T

BUSINESS media regularly seeks to seize a fresh story to grab reader attention. During the month of September we were warned of the risk of a failing Chinese real estate market and the latest U.S. political stalemate.

A CURRENT publicized concern is inflation risk. Inflation is, indeed, damaging to GDP and economic growth. As it increases, it weakens consumer demand, triggers higher interest rates and causes GDP to decline as production adjusts to lower levels of economic activity*. It's a deceptive and persistent threat because it can originate in good times or bad.* For example,

IN GOOD times: High employment levels and a shortage of good skilled labour can trigger higher labour costs and lower productivity. In the meantime, continued consumer demand can place pressure on the balance between supply and demand, leading to higher costs.

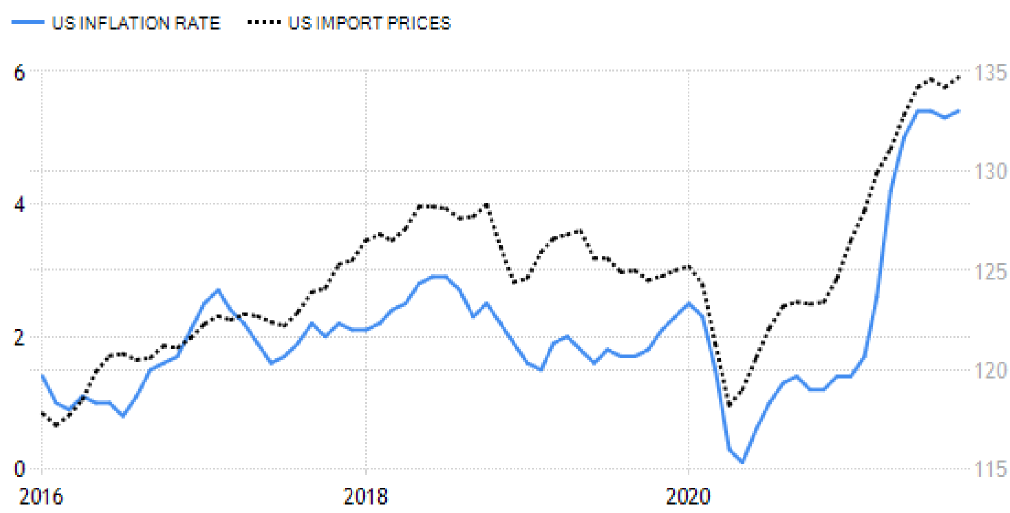
Consumer Demand Outpacing Production:



Source: Tradingeconomics.com

IN BAD times: Weak employment . . . Weak consumer demand . . . Weak GDP causing depreciation in the value of the currency . . . higher cost of imported goods.

Inflation vs Import Prices:



Source: Tradingeconomics.com

BUT, it can also be superficial and short lived affecting only certain sectors or otherwise longer lasting core inflation.

IN THE SHORT term: Non-economic circumstances such as weather, political, medical events causing a temporal disruption in regional or global economic production. Inflation would persist until the event passes.

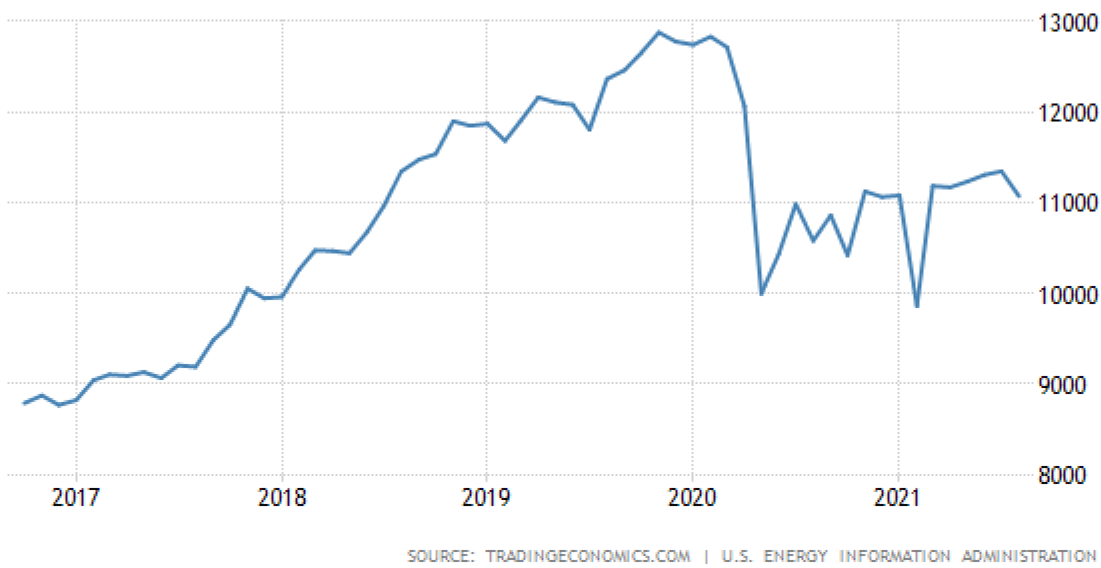
IN THE LONGER term: Core economic components such as workforce and infrastructure can weaken due to major events such as wars, extreme weather changes and new technologies,. This renders the value of goods and services produced to diminish and requires a longer term re-building of core economic factors of production.

THE DOMINO EFFECT:

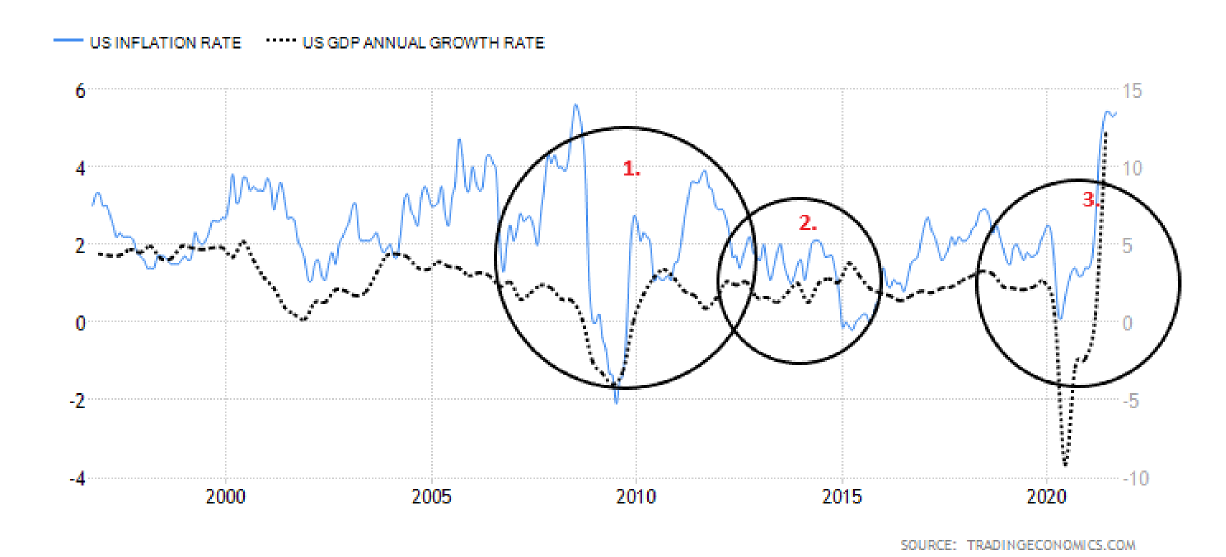
Source: Google Images

Inflation becomes more complicated when good and bad, longer and shorter term factors combine. This runs the risk of a domino effect throughout the economic chain which can affect overall GDP. **We are seeing this in the global supply chain of goods as the pandemic has affected production especially abroad and is interrupting the supply of goods needed to continue production at home. For example, the shortage of computer chips manufactured abroad and required in the manufacture of new cars is slowing production and causing the price of available cars to increase. Similarly, oil supplies have not fully returned to pre-Covid levels resulting in a current rise in the price of gas until supply is ramped up again.**

Decline in Oil Production Since Outset of the Pandemic:



However, historical performance demonstrates that eventually economic forces adjust to contain the risk until another event arises. Consequently, inflation has generally been a short lived situation particularly where non-economic events have been the primary initiators.



Legend:

1. ***Consumer driven borrowing demand created inflation which led to the 2008 recession. This was followed by a period of core inflation due to economic weakness until economic conditions stabilized.***
2. ***Inflation can co-exist with economic growth provided it remains within tolerances in and around 2% as targeted by the North American central banks.***
3. ***Current concerns about inflation have been triggered by the pandemic which has interrupted the supply chain of goods and services, creating a supply / demand imbalance. However, given the amount of idle capital still available for investment as well as a segment of the labour force which has not yet returned to work, there is a considerable likelihood for improvement in the supply chain which will reduce inflation pressure.***

THE CURRENT SITUATION:

- **The Covid pandemic is a non-economic event which has persisted to interrupt and reduce economic productivity.**
- **Businesses around the world reduced and in some cases ceased production of goods and services due to the economic interruption and sudden decline in demand caused by the uncertainty surrounding the pandemic. This has led to a temporary shortage of goods and services rather than the inability to produce them.**
- **While government benefits to displaced workers has prevented an economic recession, continued government benefits are hindering a return to fuller employment and productivity improvement as some workers are choosing to delay a return to work. This is slowing the re-building of inventories.**
- **Many business sectors have adapted and are operating profitably at pre-pandemic levels. However, consumer demand has also increased to beyond the current level of available supply.**

WHAT'S THE TAKEAWAY:

INFLATION CONTINUES TO BUILD IN RESPONSE TO THE PERSISTENT IMPACT OF THE PANDEMIC ALTHOUGH COMPANIES CONTINUE TO ADAPT AND REMAIN PROFITABLE. HOSPITALITY AND TOURISM CONTINUE TO LAG BUT ARE ALSO GRADUALLY RE-BUILDING BUSINESS.

THE SUPPLY CHAIN REMAINS A KEY SOURCE OF INFLATION PRESSURE ALTHOUGH THIS IS ALSO CORRECTING ITSELF AS INVENTORIES CONTINUE TO RE-BUILD. THEREFORE, INFLATION IS LIKELY TO RETREAT AS WE PROGRESS INTO 2022. THIS CAN BE SEEN IN THE RECURRENCE OF MOMENTUM IN THE FINANCIAL MARKETS WHICH IS FORWARD LOOKING AND INVESTS FOR THE FUTURE.

IN THE MEANTIME WE SHOULD EXPECT THE CENTRAL BANKS TO STEP IN AND EXERCISE MECHANISMS SUCH AS HIGHER INTEREST RATES TO CONTROL DEMAND FORCES UNTIL THE RISK RECEDES.

Regards

Ermes Monaco, CIM®
Portfolio Manager

iA Private Wealth | MONACO CAPITAL MANAGEMENT
2075 Kennedy Road, 5th Floor
Scarborough, Ontario M1T3V3
T: 416-412-4254 | e.monaco@iaprivatewealth.ca
Toll free: 1-866-402-2641
F: 416-412-4286 | www.monacocapitalmanagement.ca

iA Private Wealth

MONACO
CAPITAL
MANAGEMENT

Note: This newsletter is proprietary and only for the benefit and use of clients of MONACO CAPITAL MANAGEMENT, iA Private Wealth.