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Economic Regime Change Part I: What's Old is New Again

"In the 1940s, economics started getting highly mathematical. It was basically because economists weren't smart enough to write down models of real behavior that they started writing down models of highly rational behavior – and they kind of forgot about humans."

- Richard Thaler, Nobel Prize-winning economist

The Through Line: In recent years, the global order has rearranged itself on a number of fronts. Some shifts have been subtle and cumulative. Others have been more jarring and sudden, demanding quick reactionary pivots. These changes hint that we can expect permanently altered trajectories and norms that will have widespread impact on global trade relationships, businesses, consumers, employees and markets. In coming weeks, we will delve into core aspects of the transformations, sketching potential outcomes and implications for investors. We begin the adventure this week by looking at inflation, interest rates and the retooling of the global economy.

In search of the new normal

Investors are conditioned to immediately run like gazelles in the opposite investing direction the second anyone utters the phrase "things are different this time." They interpret this market adage as a sign of impending disaster – like a bubble getting ready to burst. We'll let you in on a little secret, though: things are almost *always* different than the last time. Capitalism, a.k.a. the business of business, is a restless undertaking – always striving, adapting, pushing forward and kick-starting change on the fly.

At the best of times, economists and strategists have a tough time modeling broad economic systems. When the pace and scope of change accelerates, which has happened over the past 18 months, it becomes even more difficult for them to make projections. The economy and markets have been pelted with a lot of arc-bending change coming from many fronts simultaneously: technological, demographic, societal and geopolitical. A lot is still in flux, but we believe we can spot some distinct indicators pointing to where everything is headed – even if the arc is tilted in a slightly new and different direction.

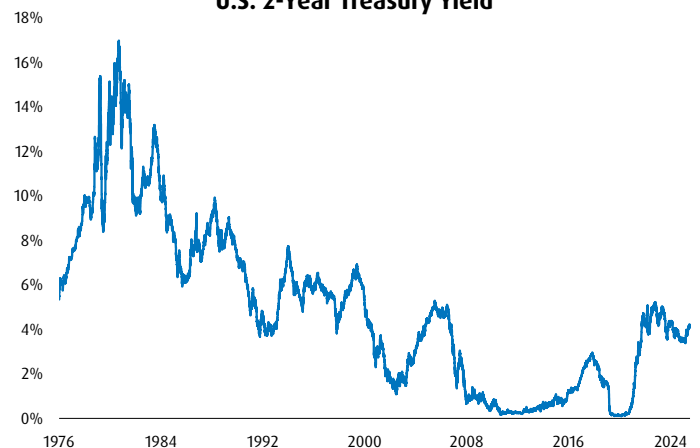
R.I.P. ZIRP and NIRP – the rebirth of inflation

Take inflation and interest rates, for example. During the better part of the last several decades, prevailing short-term interest rates and inflation hovered in the very low single digits. The U.S. Federal Reserve's biggest challenge, in fact, was trying to coax inflation *up* to its 2% target. In this period, there were several different instances when more than \$17 trillion in global sovereign debt was priced with yields *below* zero.¹

Global central banks helped propagate the super low rate backdrop by cutting policy rates aggressively: first in the early 2000s after the tech bubble burst and again in the wake of the Great Financial Crisis (2008-09). The extended period of zero interest rate policy (ZIRP)

or even negative interest rate policy (NIRP) taught a generation of investors, borrowers and business leaders to treat near-zero inflation and lending rates as the norm. The post-COVID world changed that, pushing both rates and inflation back up toward more historically familiar levels. Recall that during much of the period after WWII, U.S. CPI inflation averaged 3.7%. **What seems like something brand new is realistically a return to a more natural (and historically accurate) state of being.**

U.S. 2-Year Treasury Yield

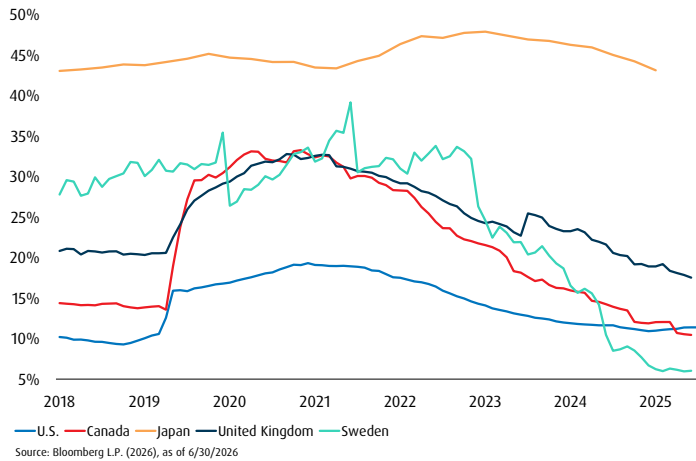


Source: Bloomberg L.P. (2026); As of 7/7/2026

Several factors are coming together to put a structural floor under inflation:

- **GFC and pandemic monetary stimulus are being unwound.** Central banks that once expanded balance sheets by buying debt, including sovereign bonds, are now allowing holdings to mature or actively reducing them.

Government Debt Held by Central Banks as % of Outstanding



- **On the flip side, most governments in developed markets have increased their issuance of debt to fund growing deficits.** Much of it has been issued with near-term maturities, consequently forcing short-term rates even higher due to the supply/demand imbalance. Extra supply is also coming from T-bills issued to back stablecoin (cryptocurrency that per U.S. law must be backed by low-risk securities like U.S. T-bills).
- **Choke points are evident in many parts of the supply chain.** This is happening because the world is fast-forwarding the construction of infrastructure required to fully deploy and benefit from new technologies. Other factors are adding cost to the economic base, including the move to reshore manufacturing. To operate successfully, long-term structures require ongoing maintenance, increased budgets and depreciation expenses. Tariffs also play a role. Though overall tariff rates are lower than they were at their worst point in April last year, average aggregate tariffs levies are approximately four times higherⁱⁱ than they were at the start of last year.

Tech is no longer deflationary (at least for now)

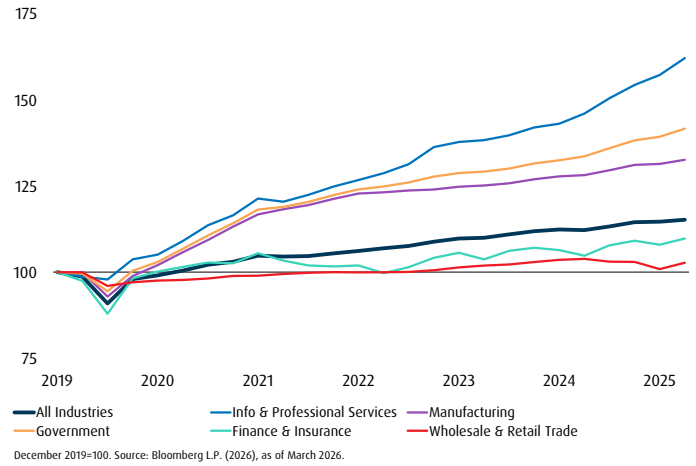
For decades, Moore’s Law (a doubling of power and a halving of cost every two years) helped tech achieve a largely deflationary role in the economy. The push to rapidly expand onshore manufacturing in key industries (e.g., semiconductors, batteries, mining/drilling, advanced military equipment) is shifting the asset-light/services-biased economy to one that’s more asset dense – and operationally more expensive/lower margined.

The lack of investment in global infrastructure over the last few decades is coming home to roost: participants in AI and AI-adjacent fields are battling for a bigger share of capacity and higher priority. The most recent case of course comes from the memory-chip market where participants note some semblance of balance likely won’t be achieved until late 2027 or beyond – and prices are up triple digits or more in the meantime. Additionally, data centers only have about half (or less) the life span of similarly sized industrial space. Chips must be written off/replaced, which builds in upgrade schedules and higher costs for an industry that has traditionally been asset light. As more and more of the data-center spend is funded with debt, the need to service that debt is another added expense.

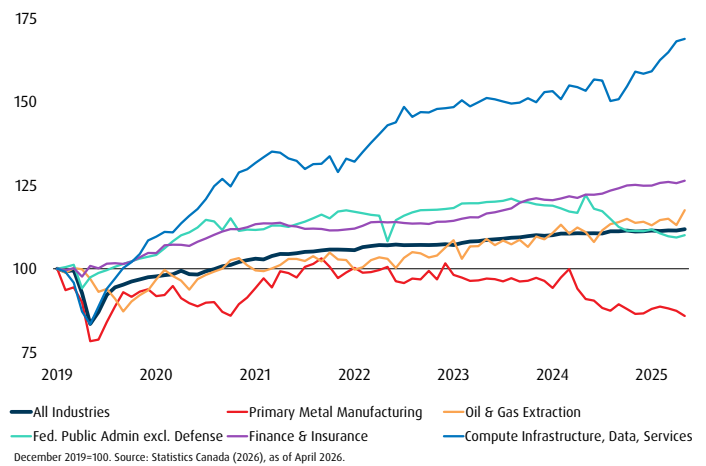
Retooling for the 21st century

In recent years, services activities have generated an increasing proportion of economic activity in both the U.S. and Canada.

U.S. Real GDP



Canada Real GDP



The global ground rules have radically shifted thanks to policy changes the U.S. initiated last year. These changes involved tariffs, immigration, reduced regulation, enabling of new technology frameworks, expansionist rhetoric/activities involving Canada, Greenland, Venezuela and Cuba, plus demands that NATO allies step up their defense spending. Coupled with the retooling necessary to deploy and use new technology, the nature and trajectory of economic activity (and costs/inflation) are likely to evolve in different ways in the years ahead.

- **Supply chains are likely to morph from “just in time” to “just in case.”** JIT entailed keeping little, if any, inventory on hand and relying on speedy shipping from the cheapest manufacturing locale to get it into customers’ hands. Recent years have reinforced (over and over) the danger of relying on single trade routes – especially those located in geopolitically fraught regions. Tariffs and fraying trade pacts have rearranged trading partners and consortiums. For example, this week the premiers of Alberta and Ontario unveiled a proposal to build a 2,000-mile “Northern Shield”

oil pipeline. Constructing new distribution networks closer to home and/or providing for redundancy will add cost and take time in the near term but should provide long-term benefit.

- **It's bigger than "just" data centers.** We're talking about roads, bridges, ports, navigational routes, AI-assisted logistics, security, cyber security, warming seas that allow more arctic navigation and put northern routes/ports into play. And then there's the space and inter-planetary framework that needs to be built. *Bottom line: plenty of activity to keep things humming for a VERY long time.*
- **More infrastructure = higher embedded maintenance costs.** Building resiliency into the system is 1) overdue and 2) necessary. However, it also likely leads to higher cost/maintenance in the long run. Data centers – and the chips that drive them – have shorter lifespans than traditional manufacturing capacity. Some cost considerations can be written off quickly (thanks to tax breaks in last summer's OBBBA). Others must be capitalized – but for a shorter time than traditional plants and equipment.
- **Tech titans increasingly meddle.** Industry heavyweights are becoming a more prominent presence in Washington affairs even while the government is conducting many of its own industrial-policy experiments. Industry groups (e.g., crypto and AI) are playing an increasingly larger role in elections from a stance that is pro-issue rather than politically partisan.

Implications of economic regime change

Many trends set in motion years ago gained momentum when the policies and priorities of a new U.S. administration ran headlong into the most significant technological advancement of our time. The impact on inflation and the actual foundational structure of the global economy have been rearranged.

Business leaders are learning on the fly how to manage higher costs (and, for younger managers, how to budget for more normal levels of inflation). Luckily, muscle memory is finely tuned among this set after repeated challenges of the past decade. Then, too, there are counterbalancing factors in the form of loosened regulation, higher tolerance for large mergers and acquisitions, favorable tax treatment for strategic activities (e.g., research and development, plant and equipment investment) and the outline of workable ground rules in key emerging industries.

Stock investors will continue to see volatility as fundamentals and fortunes emerge, turn, shift and evolve. Trends favor longevity and broadening, given the sheer magnitude of opportunity that lies ahead in new technologies coupled with old-line industries, all engaged in a race to upgrade operating leverage. Shifting global alliances and lower valuations (in some locales) should support global and market-cap diversification.

Fixed income investors are benefiting from higher overall yields, even on cash (especially relative to the ZIRP/NIRP days). But they will need to be mindful that higher financing costs for governments and businesses may upend business models/budgets that worked back when prevailing rates were lower.

In summary, investors need to remember that change is the only constant. With change comes opportunity. And that's not a bad thing.

Next week in North America

A delightfully eco-data-rich week, offering a sprinkling of reads on business progress and sentiment. The CPI and PPI releases in the U.S. will be thoroughly parsed for signs of inflation (temporary versus lasting) and who is bearing the brunt (producers or consumers). The Bank of Canada meets on Wednesday – no change expected in policy rates. The U.S. earnings report season kicks off on Tuesday with a marathon of Money Center reports that should give insight into the health of consumers and businesses.

Monday 7/13:	U.S. Federal budget balances, House and Senate are back to work Canada Bloomberg Nanos Confidence
Tuesday 7/14:	U.S. NFIB small business optimism, ADP weekly employment, CPI, Fed Chair Warsh testifies at House Financial Services committee Canada none scheduled
Wednesday 7/15:	U.S. Empire State manufacturing index, PPI, Fed Beige Book Canada BoC Rates decision, Existing home sales, Wholesale sales
Thursday 7/16:	U.S. Initial jobless claims, Philly Fed business outlook, Retail sales, Business inventories, pending home sales Canada Housing starts
Friday 7/17:	U.S. Import prices Canada International securities transactions



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