THE PLAYBOOK

CI ASSANTE WEALTH MANAGEMENT

MONTHLY COMMENTARY

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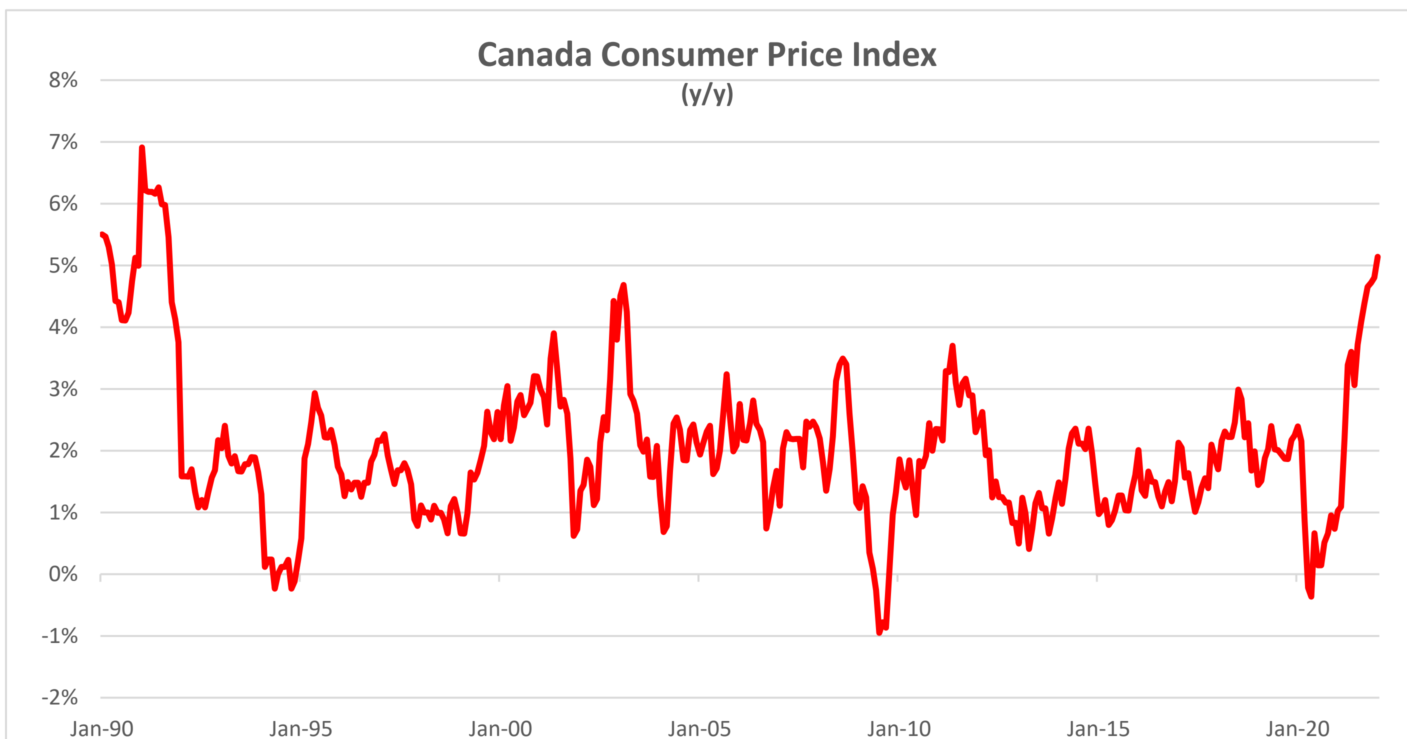
Canadian inflation hits new high



Source: Statistics Canada

MARKET FOCUS

Canadian consumer prices surge

The latest data from Statistics Canada revealed a 0.6% (seasonally adjusted) increase in the consumer price index (CPI) during January 2022. This advance was the 18th consecutive monthly gain. The steady march higher has revealed a stark contrast from concerns over potential "***deflation***" that prevailed during the early part of the COVID-19 pandemic. As can be seen in the accompanying graph, inflation on a year-over-year basis was in negative territory (-0.4%) in May 2020. Considerable commentary

suggesting that the price pressures were "transitory" has accompanied the extended string of "above expectations" CPI results. While some analysts contend that a move down should be anticipated, there is no certainty that inflation has peaked. With the January figures, the annual CPI gain stood at 5.1%. This is now the fastest pace of inflation since September 1991 (5.5%). Ironically, it was in 1991 that the then-Governor of the Bank of Canada (BoC) John Crow first introduced inflation targeting as a policy tool. More recently, the market was surprised when the BoC did not raise administered interest rates at their January 26 policy meeting. With a string of rate hikes now anticipated for the balance of the year, it remains to be seen if the market will continue to judge the BoC as being behind the curve.

U.S. economy

The U.S. Bureau of Economic Analysis announced that real gross domestic product (GDP) grew at an annual rate of 6.9% in the final quarter of 2021. In the third quarter of 2021, real GDP increased by 2.3%, and for the calendar year, real GDP growth was reported at 5.7%. This was more than sufficient to reverse the annual 3.4% contraction recorded for 2020. In fact, it was the strongest single-year advance since 1984 (7.2%). Not surprisingly, economic growth has accompanied the re-opening and the massive fiscal stimulus related to COVID-19 spending. A tightening labour market has emerged. Steady gains in non-farm payrolls have allowed the unemployment rate to drop to the 4.0% level. However, while inflation averaged 4.3% in 1984, the latest reading pegged annual growth in the CPI at 7.5% in January. The U.S. Federal Reserve will clearly have a balancing act on its hands as it moves to implement tighter monetary policy.

LONGER VIEW

Interest rates are at their bottom with the next move likely to be higher, and some investors are hung up on when this will take place. Judging by economic growth, unemployment rates and inflation, we believe the economies are ready for higher rates. So, anytime is fine as long as it is gradual and does not present a shock. We are confident central banks will be managing the hike cycle carefully. How much higher? We suspect the terminal rate is around 2%. A terminal rate is the maximum lending rate of a central bank at the end of a hike cycle. Two percent is substantially lower than normal; but it is important to recognize that we are in a "new normal" where the debt outstanding is significantly bigger, and lower is actually reasonable.

Economies typically start to slow as interest rates peak. We expect central banks to take their time to hike rates to 2%, in possibly two if not three years. Given that 2% is a low hurdle compared to corporate earnings growth, equity should continue to perform as it is obvious that certain sectors will fare better. Long-dated bonds, both 10-year Canada government bonds and U.S. Treasury bonds, are currently yielding below the terminal rate and unlikely to improve anytime soon.

For more information, we encourage you to speak to your advisor or visit us at assante.com

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