MONTHLY COMMENTARY

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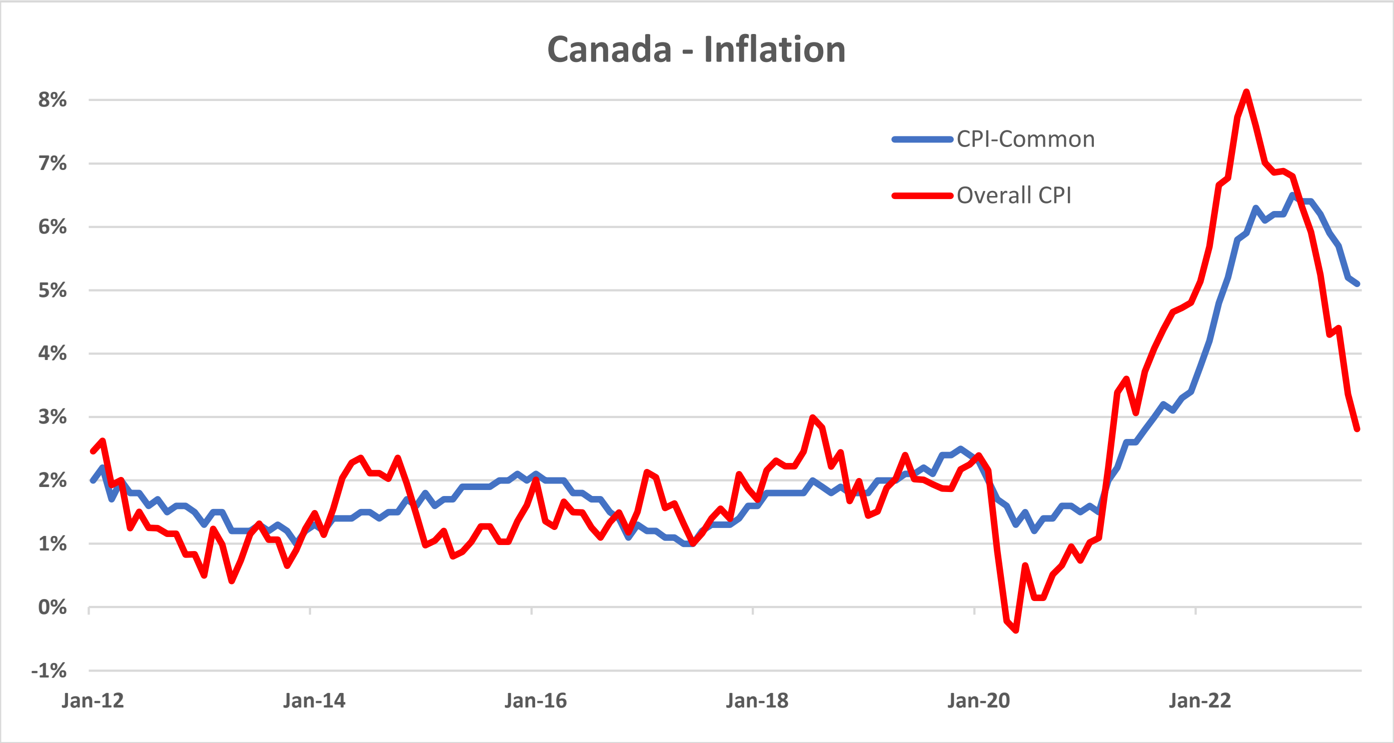
Core inflation – higher for longer



Source: Statistics Canada

MARKET FOCUS

Bank of Canada's alters forecast

The latest figures from Statistics Canada revealed that its consumer price index rose 0.1% (seasonally adjusted) in June. On a year-over-year basis, the CPI was up 2.8%. This was below the reading of 3.4% in May and well off the 8.1% peak figure recorded in June 2022, which was the fastest pace since January 1983 (8.2%). However, as can be seen in the accompanying graph, the Bank of Canada's primary core inflation measure has not kept pace. CPI common, which the central bank says is most closely correlated with the nation's output gap, edged down to 5.1% from 5.2% in the June report. At its July policy window, the Bank of Canada

announced that it was raising administered interest rates by another 25 basis points (a basis point is 1/100th of one per cent). The range for overnight borrowing was set at 5.00% to 5.25% with the official bank rate at 5.25%. This move followed a June interest rate hike (of also 25 basis points) and two prior “on hold” policy announcements. The cumulative 475 basis points of tightening that began on March 2, 2022 is the largest set of interest rate increases since November 1987 to May 1990, when the bank rate was moved from 8.09% to 14.05% (596 basis points). The last time the bank rate stood at 5.25% was April 16, 2001. More importantly, the announcement included information regarding the Bank of Canada’s latest forecast, stating that “CPI inflation is forecast to hover around 3% for the next year before gradually declining to 2% in the middle of 2025. This is a slower return to target than was forecast in the January and April projections.” The next policy announcement is scheduled for September 6, 2023.

U.S. consumers hold back.

Updated data from the U.S. Census Bureau raised concerns over the direction of consumer spending. The bureau announced that retail and food services sales edged 0.2% (seasonally adjusted) higher in June. The small advance left annual growth at 1.5% compared to June 2022. More importantly, the June tally left retail spending virtually unchanged for the quarter. This is now the weakest quarterly result since the third quarter of 2021 when there was an annualized decline of 0.3%. At the same time, the U.S. Federal Reserve reported that industrial production had declined by 0.5% in both May and June. Together, these reports raise concerns over the health of the broader U.S. economy in the second quarter of 2023.

LONGER VIEW

The Federal Reserve has raised rates aggressively this year and that is expected to cool inflation. The side effect of this strategy is a slowing economy and rising unemployment. Until we know how bad these side effects will be, the markets will remain a “guessing game.” Over the long term, we expect rates to average 2.25% to 2.5%; this means the 10-year bond at 3.7% yield today is oversold. Stocks will likely continue to benefit from low long-term interest rates and technology advancement. Economic cycles have been short and volatile as they are heavily influenced by dramatic policies. Therefore, investors should not be overly excited or concerned about what they see in the immediate term.

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

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