August 2022 market update

Central banks likely to continue lifting rates despite a drop in headline inflation

Sept. 8, 2022

Introduction

Global equity markets started relatively strong in August before pulling back after the U.S. Federal Reserve Board ("Fed") signalled it would likely keep aggressively raising interest rates to tame inflation. While inflation remained elevated in July, it did slow across Canada and the U.S. In Europe and the U.K., it continued to tick higher, largely in response to upward pressure in energy prices due to the conflict in Ukraine. High inflation hindered global economic activity.

In Canada, the S&P/TSX Composite Index posted a drop, dragged down by the Real Estate and Information Technology sectors. In the U.S., the S&P 500 Index fell, and the tech-heavy NASDAQ Composite Index posted an even bigger drop. Yields on 10-year government bonds in Canada and the U.S. both advanced. Among major commodities, oil and gold prices finished lower in August.

Fed and BoC likely to remain aggressive

Despite subsiding inflationary pressures in July, albeit only slightly, central banks in Canada and the U.S. still appeared to remain on aggressive rate hike paths. In Canada, the inflation rate slowed to 7.6% in July, from June's 40-year-high 8.1% rate. The slowdown came amid a sharp drop in gasoline prices. However, consumer price growth has been more broad-based than simply on energy prices. Based on the average of core measures, the core inflation rate increased to 5.3% year-over-year, from 5.2% in June. As elevated price pressures persist, the Bank of Canada will likely remain aggressive in its approach to taming surging inflation.

In the U.S., the inflation rate decreased slightly from 9.1% to 8.5% in July, which raised hopes inflation has peaked and upcoming rate hikes by the Fed may ease. The minutes from the last Fed meeting revealed that officials expect rate increases to slow as inflation tames or economic conditions worsen. However, subsequent comments from Fed officials muted expectations of lower rate increases. St. Louis Fed President James Bullard indicated he believes another 75-basis-point ("bps") rate increase is warranted at the Fed's next meeting. Then, at the Jackson Hole Economic Symposium, Fed Chair Jerome Powell indicated the Fed is committed to combating inflation, and another large rate increase is likely at its next meeting. Future rate hikes will be determined based on the path of inflation and U.S. economic conditions.

Energy prices surge in France and Germany

The energy crisis across Europe continued in August, particularly in Germany, the region's largest economy. It is straining consumers across Europe and has been a key factor in pushing inflation to a level that has forced the European Central Bank to begin lifting interest rates. In France, the price of electricity rose to a record price in August in response to low supply of natural gas from Russia, and less nuclear power generation. Meanwhile, Germany has been particularly hard hit by the energy crisis. The price of electricity also rose higher during the month, while higher gas prices continued to weigh on consumers and its key manufacturing sector. Given the shortage, there is much concern that Europe could see rolling blackouts as winter approaches. However, Germany, and Europe, are taking steps to help alleviate their dependence on Russian oil. Germany has struck a five-year hydrogen agreement with Canada, but the first shipment is likely a few years away, which will not solve its immediate energy shortage. The European Union ("EU") has announced it is developing a plan to structurally reform its electricity market, originally developed under much different circumstances. The EU hopes this may help drive down energy prices.

U.K. economic conditions appear bleak

Economic conditions in the U.K. appear to be waning, and the outlook appears equally dismal. The conflict in Ukraine, surging inflation, high energy prices and rising interest rates are hindering economic activity. In a preliminary estimate, the U.K. economy contracted by 0.1% in the second quarter of 2022, its first decline since the first quarter of 2021. The U.K. economy was negatively affected by a drop in household spending during the quarter, which isn't surprising given the sharp increase in consumer prices. The U.K. inflation rate reached 10.1% in July, its sharpest increase since February 1982, with upward pressure coming from price increases for food, along with housing and utilities. Energy prices also pushed higher. With little sign of inflation abating in the near term, the Bank of England ("BoE") raised its key interest rate by 50 bps to 1.75%. It was the sixth consecutive rate increase by the BoE. The outlook from the BoE was bleak. It expects inflation to reach 13.3% by October, with the U.K. economy falling into a recession by the fourth quarter of 2022 and weak economic activity expected to last for another five quarters.

Unexpected rate reduction to help boost China's economy

As China's economy slowed considerably, the People's Bank of China ("PBOC") took action to try to help boost economic activity. After its economy shrank in the second quarter of 2022, China reported a significant decrease in both domestic demand and industrial production. On a year-over-year basis, retail sales rose by 2.7% in July, missing expectations and slowing from the 3.1% annual pace of growth in June. At the same time, China reported its industrial production grew at a 3.8% pace in July, down slightly from the 3.9% increase in June. The slowdown came amid its ongoing COVID-19 lockdowns, waning global demand and ongoing supply chain issues. In response to the slowdown in these two key economic indicators, the PBOC announced it was reducing its one-year medium-term lending facility interest rate by ten bps to 2.75%. The reduction was unexpected by market participants. Then, later in August, the PBOC reduced its one- and five-year loan prime rates by five bps and 15 bps, respectively. The PBOC hopes these rate reductions will help lift economic conditions and support its property market, which has floundered in recent quarters.

Market performance - as at Aug. 31, 2022

Equity Markets	Level	Month to date	Month to date (C$)	Year to date	Year to date (C$)	1 year	1 year (C$)
S&P/TSX Composite Index C$	19,330.81	-1.84%	**-1.84%**	-8.92%	**-8.92%**	-6.08%	**-6.08%**
S&P 500 Index US$	3,955.00	-4.24%	**-2.13%**	-17.02%	**-14.09%**	-12.55%	**-9.30%**
Dow Jones	31,510.43	-4.06%	**-1.94%**	-13.29%	**-10.23%**	-10.89%	**-7.58%**

Industrial Average US$							
MSCI EAFE Index US$	1,840.50	-4.99%	**-2.90%**	-21.21%	**-18.44%**	-21.89%	**-18.99%**
MSCI Emerging Markets Index US$	994.11	0.03%	**2.24%**	-19.31%	**-16.46%**	-24.04%	**-21.21%**
MSCI Europe Index US$	1,595.21	-6.47%	**-4.41%**	-23.79%	**-21.11%**	-23.61%	**-20.77%**
MSCI AC Asia Pacific Index US$	158.53	-1.13%	**1.05%**	-17.91%	**-15.02%**	-21.44%	**-18.52%**

Fixed Income Markets	Level	Month to date	Month to date (C$)	Year to date	Year to date (C$)	1 year	1 year (C$)
FTSE Canada Universe Bond Index C$	1,055.66	-2.74%	**-2.74%**	-11.31%	**-11.31%**	-11.26%	**-11.26%**
FTSE World Investment Grade Bond Index US$	204.77	-4.10%	**-1.98%**	-16.09%	**-13.13%**	-18.45%	**-15.42%**

Currencies	Level	Month to date	Month to date (C$)	Year to date	Year to date (C$)	1 year	1 year (C$)
CAD/USD	0.7616	-2.28%	-	-3.49%	-	-3.65%	-

Commodities	Level	Month to date	Month to date (C$)	Year to date	Year to date (C$)	1 year	1 year (C$)
West Texas Intermediate (US$/bbl)	89.55	-9.20%	-	19.07%	-	30.73%	-
Gold (US$/oz)	1,711.04	-3.11%	-	-6.46%	-	-5.66%	-