July 2023 market update

Mortgage costs continue to drive inflation

Aug. 9, 2023

Introduction

Global equity markets moved higher over the month of July. Investor sentiment was largely positive as economic data pointed to the strong likelihood of the global economy avoiding a recession this year. Still, returns were muted as global central banks lifted rates and economic data was largely unimpressive. The U.S. Federal Reserve Board ("Fed"), Bank of Canada ("BoC") and European Central Bank ("ECB") all raised interest rates by 25 basis points ("bps") over the month. Business activity was relatively subdued in many parts of the world, as measured by manufacturing and services sector activity, largely hindered by waning consumer and business demand.

In Canada, the S&P/TSX Composite Index advanced over the month, benefiting from the relatively strong performance of the Health Care sector. U.S. equities, as measured by the MSCI USA Index, also rose higher over July. Yields on 10-year government bonds in Canada and the U.S. edged higher. In commodities markets, the price of oil posted a double-digit gain, while gold prices also ticked higher.

Higher mortgage costs keeping Canada's inflation elevated

July brought some good news for price pressures in Canada when Statistics Canada ("StatsCan") reported Canada's inflation rate moderated to 2.8% in June. This reading puts inflation in the BoC's target range, but still at the high end, suggesting the fight against inflation is not quite over. The softening in Canada's inflation has come in large part due to a decline in gasoline prices and slowdown in the growth in food prices. Recent months have highlighted a new variable that has helped keep inflation relatively high and put pressure on Canadian households. Mortgage costs have surged in recent months, rising by 30.1% in June over the same month in the previous year. The BoC's aggressive rate increases since the beginning of 2022 have put upward pressure on mortgage rates. Canadians are now faced with taking on a higher mortgage with increasing rates and elevated home prices. The BoC will now have to walk a fine line between bringing inflation back to its 2% target, while not adding undue stress to already highly leveraged Canadian households. The BoC raised its benchmark overnight interest rate by 25 bps at its July meeting, while suggesting incoming economic data will help form its future rate decisions.

Softening Canadian consumer demand weighing on sales data

Early estimates from StatsCan on sales data across the Canadian supply chain does not look promising. Consumer and business demand has remained relatively solid amid a healthy labour market and pent-up savings. But some signs indicate that ultra-tight financial conditions may be beginning to put pressure on Canadian households and businesses, particularly in June's data. Firstly, StatsCan estimates manufacturing sales dropped by 2.1% in June, which would be the largest decline since February, largely in response to lower petroleum product sales. Wholesale sales are estimated to have fallen by 4.4% in June, which would mark the sharpest drop since 2020. Businesses may be cutting back on purchases of wholesale goods amid an expected decline in consumer demand. On the consumer side, retail sales are expected to be largely unchanged in June. Sales have been choppy across all levels of the supply chain over 2023. Economists are widely expecting a slowdown in household spending in the back half of the year, particularly as savings deplete and consumers are faced with much higher borrowing costs and still-elevated consumer goods prices.

The Fed's fight against inflation continues

The Fed returned to its path of monetary tightening at its July meeting. For investors, the question then turned to whether the Fed will remain on this path or pause again at its September meeting. The U.S. central bank raised the target range for its federal funds rate by 25 bps to 5.25%–5.50%, its highest level since 2001. With the economy growing at a moderate pace and inflation still at elevated levels, the Fed believed another interest rate hike was necessary. The Fed remains committed to bringing inflation down to its 2% target. Data points to inflation indeed coming down. The Fed did not provide any clear direction on how it is leaning for its September meeting. The Fed was not the only major central bank to hold a meeting in July. The ECB raised its policy interest rate by 25 bps to 4.50%. Inflationary pressures persist but the ECB pointed out that it will keep an open mind towards either raising interest rates or holding steady at its next meeting. The Bank of Japan grabbed some of the headlines late in the month when it announced it would be more flexible with its yield curve control program and stated that its 0.50% ceiling will serve as a reference rather than the absolute maximum.

China's economy shows underlying weakness

China's gross domestic product grew at a relatively strong pace in the second quarter of 2023, but a deeper dive into the underlying numbers shows some signs of weakness prevailing in the world's second-largest economy. China's economy expanded by 6.3% year-over-year in the second quarter of 2023, which was faster than the 4.5% pace of growth in the first quarter. That headline figure was buoyed in part due to a low base year in 2022, when several Chinese cities were under strict COVID-19 lockdown restrictions. Ongoing pressures on China's property market amid high debt levels, relatively slow consumer spending and subdued manufacturing activity have all been weighing on China's economy. The People's Bank of China reduced its key interest rates in June, while holding steady in July, looking to help kickstart the economy. As signs point to weakness in China's economy, expectations are growing that policymakers may look to add more stimulus to help support growth, but the government appears slightly hesitant as a result of already high debt levels. China's government has targeted 5.0% growth over 2023.

Market performance - as at July 31, 2023

Equity Markets	Level	Month to date	Month to date (C$)	Year to date	Year to date (C$)	1 year	1 year (C$)
S&P/TSX Composite Index C$	20,626.64	2.34%	**2.34%**	6.41%	**6.41%**	4.74%	**4.74%**
MSCI USA Index US$	4,370.10	3.35%	**2.85%**	20.05%	**16.81%**	11.26%	**14.33%**
MSCI EAFE Index US$	2,199.36	3.17%	**2.67%**	13.14%	**10.09%**	13.53%	**16.66%**
MSCI Emerging Markets Index US$	1,046.81	5.80%	**5.29%**	9.47%	**6.51%**	5.35%	**8.25%**
MSCI Europe Index US$	1,985.86	2.98%	**2.48%**	14.68%	**11.59%**	16.43%	**19.64%**
MSCI AC Asia Pacific Index US$	170.75	4.60%	**4.09%**	9.64%	**6.69%**	6.50%	**9.43%**

Fixed Income Markets	Level	Month to date	Month to date (C$)	Year to date	Year to date (C$)	1 year	1 year (C$)
FTSE Canada Universe Bond Index C$	1,065.61	-1.11%	**-1.11%**	1.37%	**1.37%**	-1.83%	**-1.83%**

FTSE World Investment Grade Bond Index US$	207.73	0.50%	**0.01%**	2.73%	**-0.05%**	-3.49%	**-0.91%**

Currencies	Level	Month to date	Month to date (C$)	Year to date	Year to date (C$)	1 year	1 year (C$)
CAD/USD	0.7581	0.40%	-	2.76%	-	-2.99%	-

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)	81.80	15.74%	-	1.87%	-	-17.10%	-
Gold (US$/oz)	1,965.09	2.38%	-	7.73%	-	11.28%	-
Silver (US$/oz)	24.75	8.70%		3.35%		21.60%	