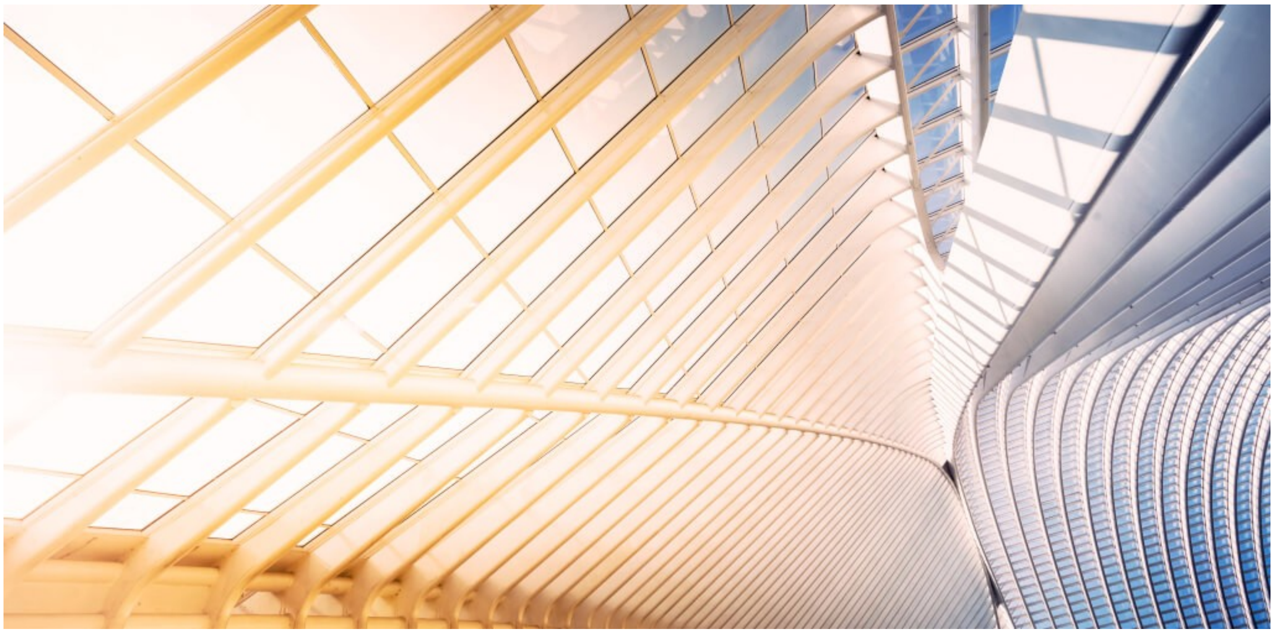
canada life™ | Investment Management

May 2023 market update

Inflation ticks higher in Canada

June 7, 2023



Introduction

Global equity markets finished slightly lower in May. Investors treaded cautiously amid uncertainty about an agreement on the U.S. debt ceiling, while inflationary pressures persisted, raising expectations central banks might be forced to keep hiking interest rates. The U.S. Federal Reserve Board (“Fed”), European Central Bank (“ECB”) and Bank of England (“BoE”) all raised rates during the month.

Data released during the month revealed the real estate markets in Canada and the U.S. gained momentum with higher sales and climbing prices. The pause by the Bank of Canada (“BoC”) and expectations that the Fed might also pause helped lift demand for real estate on both sides of the border. In Canada, the pullback in real estate over the past year has weighed heavily on economic growth. The recent rebound could influence the BoC’s upcoming decisions, particularly with mortgage costs pushing inflation higher.

In Canada, the S&P/TSX Composite Index declined, hindered by weakness in the Energy and Materials sectors. U.S. equities, as measured by the MSCI USA Index, finished higher over the month. Yields on 10-year government bonds in Canada and the U.S. finished higher but experienced wide swings amid uncertainty about the U.S. debt ceiling. Gold prices finished lower, as did the price of oil.

Canadian inflation accelerates

Canada's inflation rate unexpectedly rose during the month in April. Inflation rose to 4.4% in April, which was above March's 4.3% posted rate. This surprised economists who were expecting inflation to ease to 4.1% during the month. What drove inflation higher wasn't expected. The increase came amid higher mortgage costs and rent price growth in April compared to March. As the BoC pauses its interest rate hikes, Canada's real estate market has picked up steam with sales volumes increasing and home prices rising. This helped push mortgage costs higher. The attention now turns to the BoC. While Canada's central bank seems poised to hold its key interest rate steady at 4.50%, it has noted that it would be willing to reverse course if inflation keeps posing a risk to Canada's economy. The higher-than-expected inflation print in April, combined with a still strong labour market and economic growth, could give the BoC reason to reconsider its stance and raise rates. The BoC issues its next interest rate announcement on June 7.

The Fed considers a pause

Early in May, the Fed raised the target range of its federal funds rate by 25 basis points ("bps") to 5.00%-5.25%. While the increase was widely expected, the Fed's statement afterward gave investors reason to believe the Fed might be nearing the end of its aggressive monetary tightening period. The Fed removed a key part of their statement referring to more policy firming needed. The removal opens the door for the Fed to pause. In the meeting minutes released later in the month, Fed officials appeared divided on whether more rate hikes were needed. Some officials believed if the economy progresses in line with its outlook, it could pause, while others believed more rate hikes were needed as inflation wasn't slowing fast enough to reach the Fed's 2% target. Either way, the Fed will continue to monitor incoming economic data to set monetary policy.

The Fed was not the only major central bank to hold a meeting in May. The ECB lifted its key interest rate by 25 bps to 3.75%, its highest level since 2008. ECB President Christine Lagarde indicated the central bank might not be finished lifting interest rates as it still has come work to do to bring inflation down further. In the U.K., the BoE raised its policy interest rate by 25 bps to 4.50%, its twelfth consecutive rate increase.

The U.S. debt ceiling disagreement weighed on sentiment

Financial markets experienced periods of significant volatility throughout May as U.S. lawmakers were unable to reach an agreement on the U.S. debt ceiling. Lawmakers were pushing toward a June 1 deadline. The target was later revised to June 5, the date when U.S. Treasury Secretary Janet Yellen indicated her department would run out of cash and trigger a U.S. government default. The U.S. debt ceiling is the total amount the government can borrow to meet its existing obligations, including interest on government debt and social security. Historically, an agreement on the U.S. debt ceiling was a mere formality but has recently become a point of contention between political parties. The threat of a default and borrowing restrictions raised concerns the U.S. economy could fall into a recession, which weighed on equity markets. Fortunately, President Joe Biden and Republican Speak Kevin McCarthy were able to reach an agreement late in the month. Then, the House of Representatives and Senate both approved the bill, preventing a potential default by the U.S.

Global manufacturing activity weakens

In response to tighter financial conditions, which have weighed on demand, the global manufacturing sector experienced lower activity over the last several months. While it began to pick up in many countries across the globe, economic conditions moderated in May, hindering activity worldwide. In the U.S., manufacturing activity contracted in May after expanding slightly in April. A drop in new orders and a slowdown in output drove May's contraction. Europe saw its manufacturing sector contract for an eleventh consecutive month, sharper in May than April. China, whose economic strength is highly dependent on its manufacturing sector, posted a second consecutive contraction in May, according to the NBS Manufacturing Purchasing Managers Index. The decline in manufacturing activity worldwide suggests demand is muted, particularly as the impact of high inflation and rising rates weigh on households and businesses. According to the World Bank, manufacturing represented approximately 17% of the global economy at the end of 2021, suggesting it is a key component of global economic strength or weakness.

Market performance - as at May 31, 2023

Equity Markets	Level	Month to date	Month to date (C$)	Year to date	Year to date (C$)	1 year	1 year (C$)
S&P/TSX Composite Index C$	19,572.24	-5.16%	**-5.16%**	0.97%	**0.97%**	-5.58%	**-5.58%**
MSCI USA Index US$	3,969.21	0.47%	**0.85%**	9.04%	**9.63%**	1.08%	**8.85%**
MSCI EAFE Index US$	2,041.81	-4.76%	**-4.39%**	5.04%	**5.61%**	0.19%	**7.89%**
MSCI Emerging Markets Index US$	958.53	-1.90%	**-1.52%**	0.22%	**0.77%**	-11.06%	**-4.22%**
MSCI Europe Index US$	1,864.90	-6.52%	**-6.17%**	6.44%	**7.02%**	1.92%	**9.75%**
MSCI AC Asia Pacific Index US$	158.39	-1.20%	**-0.82%**	1.70%	**2.26%**	-6.56%	**0.63%**

Fixed Income Markets	Level	Month to date	Month to date (C$)	Year to date	Year to date (C$)	1 year	1 year (C$)
FTSE Canada Universe Bond Index C$	1,077.10	-1.69%	**-1.69%**	2.47%	**2.47%**	0.86%	**0.86%**

FTSE World Investment Grade Bond Index US$	206.22	-1.99%	**-1.62%**	1.98%	**2.54%**	-4.43%	**2.92%**

Currencies	**Level**	**Month to date**	**Month to date (C$)**	**Year to date**	**Year to date (C$)**	**1 year**	**1 year (C$)**
CAD/USD	0.7367	-0.17%	-	-0.15%	-	-6.82%	-

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)	68.09	-12.00%	-	-15.81%	-	-41.07%	-
Gold (US$/oz)	1,962.74	-1.37%	-	7.60%	-	6.82%	-