

MARKET REVIEW

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MARKET COMMENTARY

A resilient labour market combined with an uptick in inflation, which remains well above the target range, convinced the Bank of Canada (BoC) that monetary policy was not sufficiently restrictive and to resurrect its hiking cycle last week. The BoC is concerned that “excess demand in the economy looks to be more persistent than anticipated” and that the inflation rate in April rose for the first time in 10 months. The need for further policy rate increases will be dependent on incoming economic data.

Similarly, data prints over the past month in the United States reveal a growing economy not yet on the brink of recession. The tight labour market continues to buoy real incomes and fuel spending, particularly in services. That said, the tailwinds bolstering consumer spending capacity may be fizzling out as the stockpile of excess savings accumulated during the pandemic erodes and banks tighten lending standards for consumer credit. Household expenditures are a major driver of economic growth since consumer spending accounts for about 70% of U.S. GDP.

The bifurcation of the U.S. economy between manufacturing and services activity is narrowing. The ISM manufacturing index, which measures economic activity in the manufacturing sector, has contracted for the past seven consecutive months. In contrast, the ISM services index has expanded over the same period, albeit the level of activity within the service sector is slowing with the May reading now just barely above the expansion level.

So far, higher interest rates have not slowed the economy to the point where dampened demand has led to significantly weaker prices. Central banks are steadfast to bring inflation sustainably to the 2% target. Additional policy tightening and the ongoing effects of earlier increases suggest an economic slowdown is unavoidable, whilst the degree remains uncertain.

For risk adverse investors, fixed income investments now offer a real rate of return. For equity investors, short-term market dislocations represent opportunities to invest in quality income and growth companies for long-term appreciation.

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