



## Ravinsky Wealth Management Group

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100 bp hike topped widespread expectations for a 75 bp increase – BoC front-loading the path to higher rates amid excess demand



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Investors who had been hoping for a quiet start to the summer may be disappointed. The first week of July was rather busy, with a number of developments ranging from a large rate hike from the Bank of Canada to closely scrutinized inflation data in the U.S. Concerns are also rising with respect to Russia and the potential for it to cut off its supply of natural gas to Europe. Meanwhile, the second quarter earnings season has kicked off with investors both eager and anxious to learn about the resiliency or difficulties companies are experiencing in the current environment. We'll touch on the latter two issues in next month's newsletter. Below, we share some thoughts on the two former issues.

The Bank of Canada surprised investors by raising its policy rate by a full percentage point, versus the 0.75% that was widely expected. It was an understandable decision given the persistence of inflationary pressures. The Bank now expects inflation to end the year at an annual rate of 7.5%, compared to its prior forecast of 4.5%. Officials mentioned they would rather "front load" the interest rate hikes. More specifically, the Bank is hoping that by raising rates forcefully this early in its tightening cycle, it will reduce the odds of having to raise rates by an even larger amount in the future. Our firm's economists expect another 1.0% in rate increases by the end of the year.

In the U.S., the consumer price index (CPI) for the month of June was released. It rose past 9% year over year, representing the highest level in more than 40 years. More importantly, it revealed that pressures are relatively broad and continue to rise in areas such as rent, where inflation has historically been more persistent and taken time to unwind. Not surprisingly, this report paves the way for the U.S. Federal Reserve to take action. The Fed is expected to raise rates by either 0.75% or 1% when it makes its decision at its upcoming meeting at the end of the month.

Markets have been surprisingly resilient in the wake of these developments. This is in contrast to the behaviour earlier in the year when there appeared to be a greater degree of trepidation. We attribute this to a few things. First, central banks are already aggressively tackling inflation, with a series of forceful rate hikes in recent months. Second, there are signs that suggest future inflation may be poised to decline. For example, commodity prices have fallen substantially, which will eventually make its way into future inflation readings. And, some leading economic indicators, such as the yield curve, are pointing to activity that is likely to slow further in the months to come, with growing risks of a potential recession. This shouldn't be surprising. Financial conditions have tightened meaningfully in a short period of time and are starting to deliver some of the intended impact, namely a deceleration in demand. Lastly, and perhaps most importantly, measures of longer-term future inflation expectations have come down, and in some cases quite meaningfully. All this suggests that while inflation remains a serious issue at the present time, it may pose less of a challenge in the future.



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To be clear, the risks facing investors still remain elevated. However, they may be transitioning from strictly inflation oriented, towards risks that are more closely tied to other fundamental issues such as economic and earnings growth. We believe this is where some vulnerabilities may emerge, as they often do when the growth outlook is deteriorating.

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Sincerely,

The Ravinsky Wealth Management Group

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