August 2023 market update

Rising mortgage and energy costs push inflation higher despite a softening labour market

Sept. 8, 2023

Introduction

Global equity markets fell over the month of August. Investor sentiment soured on signs pointing to more interest rate increases by global central banks, concerns over U.S. government debt and mixed economic data. As reported in August, inflation remained elevated and above the targets of global central banks. Business activity across several critical economies was relatively weak in August, particularly across manufacturing sector activity.

The S&P/TSX Composite Index declined over the month, dragged down by weakness in the Consumer Discretionary sector. U.S. equities, as measured by the MSCI USA Index, also finished lower. Gold prices fell heavily over most of the month before those losses pared back by month-end. Oil prices ended largely unchanged. Yields on 10-year government bonds in Canada and the U.S. advanced.

North American inflation print moves higher

Over the past year, the Canadian and U.S. economies have seen inflationary pressures soften considerably. While still at elevated levels, market participants were encouraged by the decline. However, inflation in Canada and the U.S. bounced higher in July. But despite the increase, it likely does little to alter the current path of the Bank of Canada ("BoC") and U.S. Federal Reserve Board ("Fed"). In Canada, July's inflation rate ticked higher to 3.3% from 2.8% in June. Economists were expecting inflation to move higher. Contributing to the increase was a rise in electricity prices, along with another surge in mortgage costs. Meanwhile, energy costs continued declining but at a slower pace in July than June. South of the border, inflation increased to 3.2% in July from 3.0% in June, the first increase in 12 months. Like Canada, energy prices in the U.S. fell at a slower pace this month compared to last, while there was an increase in costs for transportation services and apparel. At the Jackson Hole Symposium in August, Fed Chair Jerome Powell indicated that the Fed's fight against inflation is not yet over, and rates may need to go higher and likely stay at restrictive levels to bring inflation down to its target. The BoC makes its next interest rate decision on September 6, and the Fed on September 20.

Canada's labour market shows signs of softening

Is there some trouble brewing in Canada's labour market? Recent data may be pointing to an affirmative response. Statistics Canada reported the Canadian economy lost 6,400 jobs in July, which marked the second time in the past three months the Canadian economy shed jobs. The participation rate edged lower to 65.6% in the month. In response, Canada's unemployment rate rose to 5.5% in July from 5.4% in June, matching economists' expectations. It was Canada's highest jobless rate since January 2022. Wage growth advanced, adding to inflationary pressures. Wages grew by 5.0% year-over-year in July, which was well above the 4.1% rate economists had expected. While the data suggests the Canadian labour market may be losing momentum, it remains relatively robust, surprising the BoC, who expected labour markets to slow amid their aggressive interest rate hikes. The healthy labour market has been critical to helping Canada's economy avoid a recession, at least to this point.

U.S. government and financial sector debt come under pressure

Ratings agencies expressed concern for U.S. government and financial sector debt over the month, resulting in lower credit ratings. In early August, Fitch Ratings began the downgrades by lowering the U.S. government's long-term foreign-currency debt rating from AAA to AA+. This was the U.S. government's first ratings downgrade since a similar move by S&P Global in 2011. Fitch believed a lack of strong governance, as evidenced by frequent tensions over the debt ceiling, rising debt levels and expectations of weakening economic conditions, could put pressure on the U.S. government's ability to manage its debt. The ratings agency projects the U.S. government's debt to rise to 6.3% of gross domestic product this year, well above the 3.7% rate in 2022. U.S. Treasury bond yields initially moved higher on the ratings downgrade. However, ratings agency downgrades did not end there. A week later, Moody's cut the ratings of 10 regional banks in the U.S. while placing six large banks on review. S&P Global then followed suit with some ratings downgrades of its own. Much of the downgrades came amid concerns about the property market and higher interest rates. In U.S. equities, the Financials sector moved lower over the month.

China's economy continues to struggle for traction

While China's government and the People's Bank of China ("PBOC") take action to help support growth, waning demand, both domestically and from abroad, continues to weigh on economic activity. China, the world's second-largest economy, saw further slowdowns in two key economic indicators: retail sales and industrial production. Retail sales growth softened to 2.5% year-over-year in July, which was the slowest pace of growth since declining in December 2022. The government's removal of strict lockdown restrictions was expected to boost consumer spending, but economic conditions have weighed on households, thus restricting spending. Results on the production side of the economy were much the same. Industrial production rose at an annual pace of 3.7% in July, down from the 4.4% growth in the previous month. Output in the manufacturing and mining sectors both slowed in July. The results of slower production levels have weighed on industrial companies, who have seen their year-to-date profits in 2023 drop by 15.5% versus the same period last year. Besides struggles in spending and production, the property market in China continues to be under pressure. Developer China Evergrande Group, which ran into debt troubles last year, filed for bankruptcy protection in the U.S. amid severe difficulties in China's property market. With so much uncertainty and waning economic activity, the PBOC reduced its one-year loan prime rate and one-year medium-term lending rate over the month, hoping to help kickstart economic growth.

Market performance - as at August 31, 2023

Equity Markets	Level	Month to date	Month to date (C$)	Year to date	Year to date (C$)	1 year	1 year (C$)
S&P/TSX Composite Index C$	20,292.62	-1.62%	**-1.62%**	4.68%	**4.68%**	6.01%	**6.01%**
MSCI USA Index US$	4,288.81	-1.86%	**0.98%**	17.82%	**17.96%**	13.62%	**16.87%**
MSCI EAFE Index US$	2,109.16	-4.10%	**-1.33%**	8.50%	**8.63%**	17.82%	**21.19%**
MSCI Emerging Markets Index US$	980.33	-6.36%	**-3.65%**	2.50%	**2.63%**	0.43%	**3.30%**
MSCI Europe Index US$	1,901.81	-4.23%	**-1.46%**	9.83%	**9.96%**	19.22%	**23.33%**
MSCI AC Asia Pacific Index US$	162.08	-5.08%	**-2.34%**	4.07%	**4.19%**	4.53%	**7.52%**

Fixed Income Markets	Level	Month to date	Month to date (C$)	Year to date	Year to date (C$)	1 year	1 year (C$)
FTSE Canada Universe Bond Index C$	1,063.65	-0.18%	**-0.18%**	1.19%	**1.19%**	1.17%	**1.17%**

FTSE World Investment Grade Bond Index US$	205.23	-1.20%	**1.66%**	1.49%	**1.61%**	1.20%	**4.10%**

Currencies	Level	Month to date	Month to date (C$)	Year to date	Year to date (C$)	1 year	1 year (C$)
CAD/USD	0.7403	-2.36%	-	0.34%	-	-2.80%	-

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)	83.63	2.18%	-	4.14%	-	-3.79%	-
Gold (US$/oz)	1,940.19	-1.27%	-	6.37%	-	13.39%	-
Silver (US$/oz)	24.44	-1.23%		2.04%		21.60%	

This commentary represents Canada Life Investment Management Ltd.'s views at the date of publication, which are subject to change without notice. Furthermore, there can be no assurance that any trends described in this material will continue or that forecasts will occur; economic and market conditions change frequently. This commentary is intended as a general source of information and is not intended to be a solicitation to buy or sell specific investment nor tax or legal advice. Before making any investment decision, prospective investors should carefully review the relevant offering documents and seek input from their advisor. You may not reproduce, distribute, or otherwise use a of this article without the prior written consent of Canada Life Investment Management Ltd.

FTSE Disclaimer (https://www.canadalife.com/investment-management/email-disclaimers.html#ftse) |
S&P Disclaimer (https://www.canadalife.com/investment-management/email-disclaimers.html#sp) |
MSCI Disclaimer (https://www.canadalife.com/investment-management/email-disclaimers.html#msci)