Monthly Market Commentary
August 2023

Stocks retreat on news from the Fed and China.

- Global equity markets recorded losses in local-currency terms in August due to investors' uncertainty regarding the direction of U.S. Federal Reserve (Fed) monetary policy, as well as worries about China's weakening economy.
- Global fixed-income assets also posted negative returns over the month. U.S. Treasury yields moved modestly higher in the intermediate and long segments of the curve, while the direction of yields was mixed in the short end. U.S. high-yield bonds were a notable exception.
- We continue to expect inflation to run structurally higher in the years ahead due to persistent labour-market tightness, the need to increase the resiliency and diversity of supply chains, and the need to offset the depressive impact of higher taxes and financing costs on profit margins.

Economic Backdrop

Global equity markets recorded losses in local-currency terms in August–just the second monthly downturn thus far in 2023–due to investors' uncertainty regarding the direction of U.S. Federal Reserve (Fed) monetary policy, as well as worries about China's weakening economy. Developed markets outperformed their emerging-market counterparts during the month. The Nordic countries recorded comparatively smaller losses and were the top performers among developed markets in August, bolstered mainly by strength in Denmark. The Pacific ex Japan region was the primary market laggard due largely to significant weakness in New Zealand. Europe led the emerging markets during the month, benefiting from notable gains in Egypt and Turkey. Conversely, stocks in Colombia and South Africa experienced double-digit losses and were the weakest emerging-market performers in August.

During a speech at the Kansas City Fed's annual economic symposium at Jackson Hole, Wyoming, in late August, Fed Chair Jerome Powell reiterated the central bank's goal of reducing the annual rate of inflation to 2%, and said that the Fed would consider additional interest-rate hikes if needed. Powell commented, “We are committed to achieving and sustaining a stance of monetary policy that is sufficiently restrictive to bring inflation down to [2%] over time.” He also noted that the central bank “will assess our progress based on the totality of the data and the evolving outlook and risks.”

China, the world's second-largest economy, has recently experienced relatively weak credit growth, a downturn in exports, and a year-over-year decline in consumer prices. Lower demand for goods and services from Chinese consumers could have a negative impact on other countries' exports of iron ore, crude oil, factory equipment, and luxury goods into the country. U.S.-based manufacturers of chemicals and heavy machinery have cautioned that they may experience a slowdown of sales in China. Additionally, a large property developer filed for protection under Chapter 15 of the U.S. bankruptcy code, which safeguards non-U.S. companies that are undergoing debt restructurings from creditors seeking to sue the firms or to freeze their assets in the U.S.

Most global fixed-income asset classes lost ground in August. However, U.S. high-yield bonds registered positive returns and were the top performers within the U.S. market for the period. U.S. corporate bonds, mortgage-backed securities (MBS) and U.S. Treasurys declined. Treasury yields moved modestly higher in the intermediate and long segments of the curve, while the direction of yields was mixed in the short end (bond prices move inversely to yields). The yield on the 2-year Treasury note dipped 3 basis points (0.03%), and yields on 3-, 5-, and 10-year notes rose 0.03%, 0.05%, and 0.12%, respectively, in August. The spread between 10- and 2-year notes moved from -0.91% to -0.76% during the month, and the yield curve remained inverted.

Global commodity prices saw mixed performance in August. The West Texas Intermediate (WTI) crude-oil spot price and the Brent crude oil price gained 2.1% and 1.6%, respectively, in U.S. dollar terms, on expectations that production output cuts from the Organization of the Petroleum Exporting Countries (OPEC) would continue through the end of 2023. The gold spot price was down 4.1% for the month due to strength in the U.S. dollar. The New York Mercantile Exchange (NYMEX) natural gas price rose 5.1% in August, benefiting from forecasts for more hot weather in the U.S., which would increase demand. Wheat prices fell nearly 10% over the month due to Russia's shipments of large quantities of cheaply priced grain.

Central Banks

- The Bank of Canada (BoC) held its overnight interest rate steady at 5.00% and continued its policy of quantitative tightening following its September 6 meeting. BoC Governor Tiff Macklem noted that higher interest rates have cooled demand, but countered that inflation, though falling, remained too high—around 3% versus the BoC target of about 2%. Further rate hikes remain a possibility if inflation does not moderate further. The next scheduled BoC meeting is scheduled for October 25.

- The Fed's next policy meeting is scheduled for September 19-20. Minutes from the Federal Open Market Committee's (FOMC) meeting in July, which were released in August, revealed that the members remain focused on curbing inflation despite the steady downward trend in the U.S. personal-consumption-expenditures (PCE) price index over the past year. Most committee participants maintained their belief that there are "significant upside risks to inflation, which could require further tightening of monetary policy." However, several FOMC members expressed the view that the Fed should take a more measured approach, noting that, "with the stance of monetary policy in restrictive territory, risks to the achievement of the Committee's goals had become more two-sided, and it was important that the Committee's decisions balance the risk of an inadvertent overtightening of policy against the cost of an insufficient tightening."

- In a split 6-3 vote, the Bank of England (BOE) raised the Bank Rate by 25 basis points (0.25%) to a 15-year high of 5.25%. Two BOE members supported a 0.50% increase, while another favoured leaving the benchmark interest rate unchanged at 5.00%. In its announcement of the rate hike, the BOE noted that, while the overall inflation rate in the UK had slowed from 8.7% to 7.9% month-over-month in June, it remained well above the central bank's 2% target. The BOE also commented, "Given the significant increase in Bank Rate since the start of this tightening cycle, the current monetary policy stance is restrictive. The Monetary Policy Committee will continue to monitor closely indications of persistent inflationary pressures and resilience in the economy as a whole, including the tightness of labour market conditions and the behaviour of wage growth and services price inflation.

- The European Central Bank's (ECB) next monetary policy meeting is scheduled for September 14. The ECB increased its benchmark interest rate by 0.25% to 4.25% following its meeting in late July.

- The next monetary policy meeting for the Bank of Japan (BOJ) will be held on September 21-22. The central bank left its benchmark interest rate unchanged at -0.1% following its meeting on July 28. However, the BOJ set a rigid upper yield limit of 1.0% for the 10-year Japanese government bond (JGB). The 10-year JGB yield ended August at 0.65%.

Economic Data (unless otherwise noted, data sourced to Bloomberg)

- According to Statistics Canada, consumer prices rose (as measured by the change in the Consumer Price Index (CPI)) 0.6% for July, and increased 3.3% for the one-year period. The primary drivers of headline inflation were baseline effects as a large decline in gasoline prices during July of 2022 is no longer part of the year-over-year calculation. Producer prices were mixed as they were higher for the month, but remained weak for the one-year period. The Industrial Product Price Index (IPPI) and Raw Materials Price Index (RMPI) climbed 0.4% and 3.5%, respectively, in July. Year-over-year prices slumped 2.7% for the IPPI and slid 11.1% for the RMPI. The Canadian economy added a modest 40,000 jobs in August. The unemployment rate held firm at 5.5%, breaking a string of three consecutive monthly increases.

- According to the Department of Labor, the U.S. consumer-price index (CPI) rose 0.2% in July, matching the monthly increase in June. The CPI advanced 3.2% year-over-year—up modestly from the 3.0% annual rise in June, which was the lowest in more than two years. The government attributed the month-over-month increase in inflation to higher costs for housing and, to a lesser extent, motor vehicle insurance. Core inflation, as measured by the CPI for all items less food and energy, was up 0.2% in July, matching the rise in June, and advanced 4.7% over the previous 12 months. The Department of Labor reported that U.S. payrolls expanded by 187,000 in August, and the unemployment rate rose 0.3 percentage point to 3.8%. The health care and leisure and hospitality sectors added 71,000 and 40,000 jobs, respectively, during the month. In contrast, transportation and warehousing payrolls declined by 34,000 in August, while the information industry saw a loss of 15,000 jobs. Average hourly earnings rose 0.2% for the month and 4.3% year-over-year. The 12-month increase was slightly lower than the 4.4% annual rise in July.

- According to the Office for National Statistics (ONS), consumer prices in the U.K. dipped 0.3% month-over-month in July—a sharp decline from the 0.6% increase in June. Inflation increased 6.4% over the previous 12-month period, down from the 7.3% annual upturn in June. Lower gas and electricity costs were the main contributors to the decrease in prices in July. Core inflation, which excludes volatile food prices, rose at an annual rate of 6.4% in July, unchanged from the year-over-year increase for the previous month. The ONS also reported that U.K. GDP grew 0.5% in June (the most recent reporting period), up from a 0.1% decrease in May, and increased 0.2% over the previous three-month period. Production output and the construction sector saw upturns of 1.8% and 1.6%, respectively, in June, versus corresponding 0.6% and 0.2% declines in May.

- Eurostat estimated that the inflation rate in the eurozone was unchanged at 5.3% for the 12-month period ending in August. Prices for food, alcohol and tobacco rose 9.8%, but the pace of acceleration slowed from the 10.8% annual rate in July. Energy prices decreased 3.3% year-over-year, following a 6.1% decline in July. Core inflation, which excludes volatile energy and food prices, rose at an annual rate of 5.3% in August, down 0.2 percentage point from July. According to Eurostat's second estimate, eurozone GDP grew 0.3% in the second quarter of 2023, improving from the flat growth rate in the first quarter, and increased 0.6% year-over-year. The economies of Ireland and Lithuania were the strongest performers for the second quarter, expanding 3.3% and 2.8%, respectively, while Poland's economy contracted 3.7% during the period.

Index Data (August 2023)

- The S&P/TSX Composite Index fell 1.37%.
- The FTSE Canada Universe Bond Index returned -0.18%.
- The S&P 500 Index, which measures U.S. equities, rose 1.15%.
- The MSCI ACWI (Net) Index, used to gauge global equity performance, was down 0.08%.
- The ICE BofA U.S. High Yield Constrained Index, representing U.S. high-yield bond markets, returned 0.26% (currency hedged) and 3.09% (unhedged).
- The Chicago Board Options Exchange Volatility Index—a measure of implied volatility in the S&P 500 Index that is also known as the "fear index"—was little changed as it moved from 13.63 to 13.57.
- The WTI Cushing crude oil price—a key indicator of movements in the oil market—moved higher from US$81.80 to US$83.63 a barrel to end July.
- The Canadian dollar weakened to C$1.35 per U.S. dollar. The U.S. dollar was stronger versus the world's other major currencies, ending August at US$1.09 versus the euro, US$1.27 against sterling, and at 145.59 yen.

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