

Big Picture

Markets Struggle for Direction; Bank of Canada Hikes Rates by 50 Basis Points

Although U.S. markets were closed for the Memorial Day holiday, the TSX continued its winning streak on Monday, hitting its highest level in nearly four weeks. Canada's main index closed 171 points higher, led by tech and financials, which rose 1.9% and 0.8%, respectively.

North American stocks fell Tuesday, however, ending the month of May on a down note, as investors continue to assess a range of concerns -- from inflation and rising rates to the war in Ukraine and slowing global growth. The Dow dropped 223 points on Tuesday, while the S&P 500 and Nasdaq fell 26 and 50 points, respectively. In Canada, the TSX snapped its seven-day winning streak, dropping 190 points on weakness in the energy and materials sectors.

Meanwhile Statistics Canada reported Tuesday that Q1 GDP grew at an annualized rate of 3.1%, setting the stage on Wednesday for another significant rate hike from the Bank of Canada (BoC).

As expected, the BoC hiked its key policy rate by 50 basis points on Wednesday, noting that the central bank was prepared to "act more forcefully," leaving analysts to wonder if a 75-basis-point hike might be an option if inflation remains unchecked.

North American indexes were in the red once again on Wednesday as trading remained choppy. The Dow dropped 177 points, while the S&P 500 and Nasdaq declined 31 and 87 points, respectively. In Canada, the TSX was essentially flat, dropping 15 points. According to analysts, indexes may trade sideways until markets have more clarity on inflation and the future path of rate hikes.

It was another volatile session for U.S. stocks Thursday, as investors parsed U.S. employment data for possible signs of cooling labour demand, which could alleviate some inflation concerns. By Thursday's close, the Nasdaq rose nearly 2.7%, the S&P 500 added 1.8% (on strength in the Consumer Discretionary sector), and the Dow rose 1.3%. In Canada, the TSX added 318 points, buoyed by the Materials, Industrials and Technology sectors.

North American Markets Regain Ground

For the four trading days covered in this report, the Dow added 35 points to close at 33,248, the S&P 500 rose 19 points to settle at 4,177, while the tech-heavy Nasdaq jumped 186 points to close at 12,317. In Canada, the TSX surged 284 points to end at 21,032.

Strategy

The Bank of Canada (BoC) announced a second consecutive 50bps rate hike

The BoC judges that further rate hikes will be necessary to rein in price pressures – After increasing interest rates by a combined 75bps in its last two meetings, the BoC has delivered a second consecutive 50bps hike, bringing the overnight rate to 1.5%. The move, which was well telegraphed by policymakers and priced in by markets, is a response to overwhelming price pressures that recently hit a 30-year high of 6.8% in April. The BoC expects inflationary pressures to strengthen in the near term before beginning to ease as pervasive input costs continue to feed into consumer prices. In April, the price of food and shelter surged to 8.8% and 7.4%, respectively, as the war in Ukraine and lockdowns in China continue to exacerbate supply shocks and cast upward pressure on commodity prices. With almost 70% of CPI categories showing YoY inflation exceeding 3%, the risk of elevated prices becoming entrenched has risen. Conversely, the central bank expects growth to remain solid in the second quarter. Up to this point, growth has remained resilient as MoM GDP increased for the 10th consecutive month in March while the labour market remains tight with unemployment hitting a record low of 5.2% and job openings soaring to an all-time high. The BoC concluded its statement by reiterating that interest rates will need to rise further to bring inflation in line with its 2% target and that the Governing Council is prepared to act more “forcefully” if needed to achieve that goal.

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