Bank of Canada Hikes Rate to 1.5%

The Bank of Canada increased its key policy rate to 1.5% on Wednesday, July 11, 2018 in a widely anticipated move reflecting the ongoing growth of the Canadian economy.

This is the fourth rate hike since June 2017. The rate, which sets the trend for rates on mortgages and other loans, has not been this high since December 2008, but there is considerably more uncertainty surrounding the pace of future increases promised by the bank.

“Higher interest rates will be warranted to keep inflation near target and [the bank] will continue to take a gradual approach, guided by incoming data,” the bank said in a statement accompanying the rate decision. The bank pointed out that the higher price of oil – now just shy of US$74 a barrel – and stronger U.S. growth are offsetting the harm caused by trade problems. But the estimate of the trade fallout does not take into account the U.S. threat to impose additional duties on imported vehicles and auto parts – a move the bank warns would cause “large negative spillovers” on consumer spending and business investment across the Canadian economy and could halt rate increases or even cause the bank to reverse course.

Absent significant trade disruptions, many economists expect three or four more rate increases by the end of next year, keeping the Bank of Canada in step with the pace of rate hikes by the U.S. Federal Reserve. At 1.5%, the benchmark rate is still well below the estimated “neutral” level of 2.5 to 3.5% – the point where rates neither heat up the economy nor put the brakes on growth.

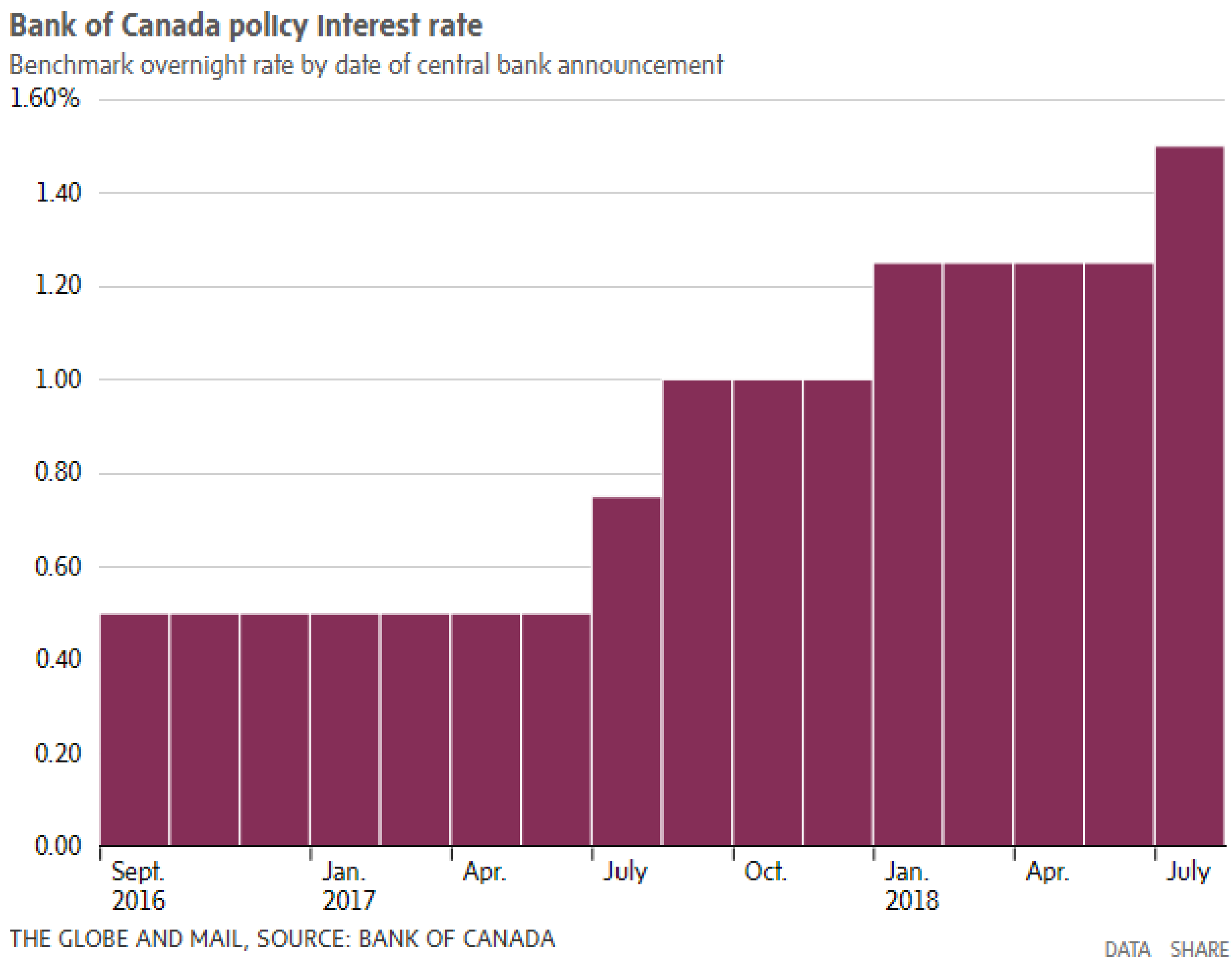
Remember that higher rates make it more expensive to borrow:

- Consumer debt servicing costs increase, household spending decreases
- Housing demand, prices, wealth effect are all slowed
- Same for Corporations, Governments
- Corporate costs increase = inflation
- Expensive deficits = reduced stimulus, upward pressure on taxes
- Demand for dividend stocks decreases as fixed income yields increase

Bonds continue to play a crucial role in the Counsel Portfolios, providing diversification and capital preservation.

Here’s what Counsel is doing to position our portfolios in this rising rate cycle:

- Increase exposures to shorter duration securities
- Diversify to global fixed income markets
- Selectively add to higher yielding securities down the credit curve



Source: The Globe and Mail, July 11, 2018