

# MARKET SPOTLIGHT—FEBRUARY 2023

## Turning the corner on inflation

Decades-high inflation over the last year has prompted central banks to aggressively hike interest rates. The Bank of Canada (BoC) raised its key interest rate for the eighth consecutive time in January 2023, bringing it to 4.5%. The central bank signaled it would pause further hikes to let the impact of its aggressive hiking cycle sink in. “We are turning the corner on inflation,” BoC Governor Tiff Macklem said, “We are still a long way from our target, but recent developments have reinforced our confidence that inflation is coming down.”

In this issue of *Market Spotlight*, Giuseppe Pietrantonio, examines what the BoC will be looking at to decide whether or not to hike interest rates again.

Nick Ciaravella, Associate, Sustainable Investments, identifies the key issues and trends he expects to impact the responsible investment landscape throughout 2023.



### What will the BoC look at to make future rate decisions?

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Which economic indicators will the BoC use to determine whether or not to hike interest rates again in its battle against inflation? The BoC will look for further easing of inflation and some cooling of the economy, as aggregate demand realigns with aggregate supply. The BoC tends to focus on where inflation will be a year out, rather than what it might be doing in any one month, as periodic economic data prints can send conflicting signals. The bank also takes into consideration the lags between interest rate hikes and the resulting effects on the economy.

#### Supply factors

The BoC will no doubt be looking closely at supply factors because supply bottlenecks, rather than above-trend demand, generated the inflation upsurge.

Inflation is expected to decline as supply chain pressures continue to ease. How much it'll decline is still uncertain as the economy has continued to run hot due to a tight labour market.

Yet, we could see real GDP surprise to the upside if inflation decelerates faster than expected, and consumer spending continues being resilient. It's apparent that the BoC's focus will be on the tightness in one key input—labour.

In its January 2023 Monetary Policy Report, the BoC indicated that inflation in Canada is still too high but has declined from its peak. It also indicated that, “As the effects of higher interest rates continue to spread through the economy, and with declines in energy prices and improved supply chains, inflation is projected to fall to around 3% in the middle of 2023 and reach the 2% target in 2024.”

On February 8, 2023, the BoC released the minutes of its January policy-setting meeting. These minutes indicated that the BoC hiked rates last month because of labour market tightness and stronger-than-expected growth.

Looking forward, if the BoC sees GDP level off or decline, and a softening in the labour market, it may leave rates unchanged as it digests the results of previous rate hikes.



## Key ESG issues and trends in 2023

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As we move further into 2023, we're attempting to identify the key issues and trends we expect will impact the responsible investment landscape throughout the year, where change is occurring at a heightened pace. It's critical to prepare for these trends to navigate the complexity and diversity of ESG and its impacts across various markets.

### Greater transparency

With increasing net-zero commitments from companies, asset managers, and asset owners, we expect more standardized emissions disclosure frameworks to emerge. This will impact how investors perceive company and portfolio emissions. It should lead to more transparent climate risk disclosures across the investment industry. This comes on the heels of COP15 in Montreal last year. With the upcoming launch of the Task Force on Nature-related Financial Disclosures (TNFD), we expect biodiversity to become a larger part of the climate conversation alongside carbon emissions.

Advances in climate and biodiversity disclosures represent part of a larger trend for enhanced sustainability disclosures and overall greater transparency. Investor expectations around transparency continue to evolve. Companies are dealing with demand for increased frequency and scope of their sustainability disclosures. There are some commonalities among requirements from global regulators, such as the EU Sustainable Finance Disclosure Regulations and the SEC's proposals. There are also plenty of divergences, which could make reporting across multiple jurisdictions a challenge for issuers. The newly formed International Sustainability Standards Board (ISSB) hopes to address these issues. It's working towards developing global standards for taxonomies and reporting requirements.

### Increasing focus on social issues

With the increase in climate-related advances in recent years, it seems as though social issues have taken a back seat. We expect this trend to reverse in the near term. For example, the UN's Principles of Responsible Investment (PRI) has already signaled that human rights and modern slavery will be an area of focus moving forward. Also, diversity, equity, and inclusion initiatives are top of mind for organizations globally.

Overall, polarization of ESG continues, and asset flows have normalized relative to recent levels. Still, we expect another year of continued progress and refinement of how investors can best integrate nonfinancial factors in the investment process.



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