Quick Take

CIO Office | September 13, 2022

The tug-of-war continues in financial markets

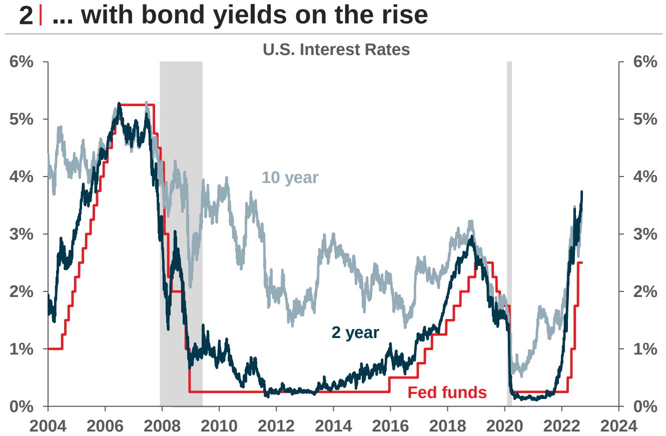
After a rather bullish start to the month, equity markets fell sharply today after inflation figures came in above expectations. As of this writing, the S&P 500 is down 3.7% (which still leaves the U.S. index 8.0% above its June low, **Chart 1**), with more severe declines for technology stocks (-4.7% for the Nasdaq), but less significant ones in Canada (-1.4% for the S&P/TSX).

1 | High volatility persists in financial markets…

CIO Office (data via Refinitiv).

In parallel, bond markets also reacted swiftly, with 2-year yields rising to levels not seen since 2007, while 10-year yields neared the highs reached last June (**Chart 2**).

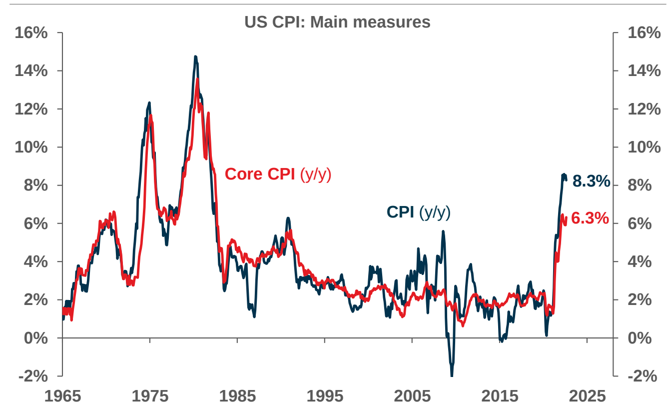
2 | ... with bond yields on the rise



CIO Office (data via Refinitiv).

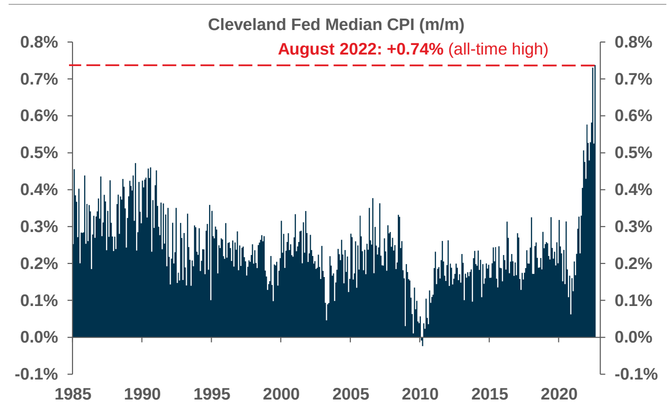
Clearly, financial markets were caught off guard by inflation numbers that, unlike last month, showed little sign of slowing this time. Granted, headline inflation fell from 8.5% to 8.3% year-over-year. However, core inflation surprised on the upside, rising from 6.1% to 6.3% (**Chart 3**). And more importantly, the median price increase for the consumer basket in August – a measure designed to monitor underlying inflationary pressures – rose to nothing less than a new record high (**Chart 4**).

3 | Modest slowdown for headline inflation (y/y)...



CIO Office (data via Refinitiv).

4 | ... but underlying price pressures remain high



CIO Office (data via Refinitiv).

In the near term, September 21 Federal Reserve meeting (next Wednesday) will be the event to

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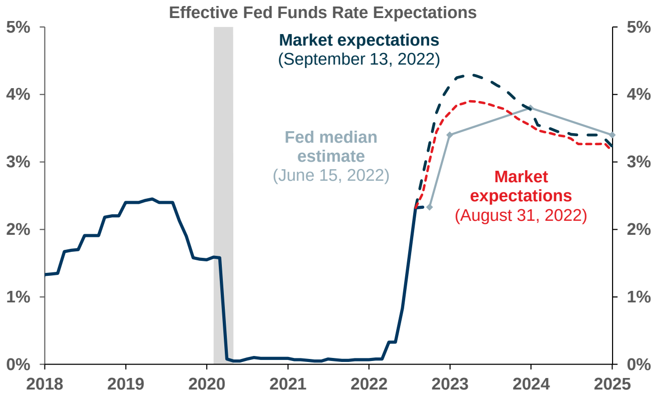
watch closely. At this stage, there is little doubt that the U.S. central bank will opt for a 75 bp hike, as did the Bank of Canada last week. Rather, it is the intentions of Fed policymakers for the next six months that remain in question, but according to market projections as of today, these could be revised upwards (**Chart 5**).

5 | A 4% policy rate by the end of the year?



CIO Office (data via Refinitiv).

In sum, while we can still anticipate a gradual slowdown in inflation over the coming year, today's numbers show that the journey will be full of obstacles and will likely see the Fed lift its policy rate into restrictive territory. Against this background, we should expect a continuation of the high volatility regime that has been ongoing for several months now, as discussed in our latest monthly Asset Allocation Strategy Report available here.

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General

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