Alert: Inflation Could Surge in 2021

Description

Have you noticed your groceries getting pricier? You've certainly noticed the cost of buying a house or maintaining it has surged. Canadians could be facing a prolonged period of inflation, which means prices of everyday essentials could rise much higher.

While the government reports that the annual rate of inflation is about 1%, the rate could steadily climb higher throughout 2021. Here's what's driving inflation potentially higher and the impact it could have on investors.

Inflation drivers

The past year has been extraordinarily bizarre. Much of the economy was shut down, which means demand for goods and services were suspended. Meanwhile, the government printed money to offer benefits to over eight million Canadians.

Economists believe the government's move to print billions of dollars to keep the economy afloat will devalue the Canadian dollar. Meanwhile, the reopening of the economy during the second half of the year will cause a surge in demand for goods and services. After a year of lockdown and low demand, producers of essential commodities such as oil and lumber won't be able to ramp up production quickly.

A combination of these factors could drive the price of everything, from meat to cars, higher. That's inflation, and it's an invisible drain on your wealth. Higher inflation means your money loses value over time. However, the most noteworthy impact of inflation could be on debt.

Inflation's impact on debt

While inflation was low last year, the Canadian government's cost of borrowing was low. The yield on the 10-year Canadian government bond was below 1%. In fact, it dipped down to 0.43% by July 2020 — the lowest point in its history.

This means the government can borrow cheaply and deploy money into the economy. It also means that the cost of borrowing for individuals and corporations is low. You may have noticed how mortgage rates fell to an all-time low in 2020.

Now, however, the yield on the 10-year government bond is up to 1.26%. That's nearly quadruple the rate from July 2020. As the cost of borrowing rises, corporations and consumers could pull back investments. That causes the stock market to correct.

In short, if inflation continues to rise you should expect the stock market to dive lower. However, inflation's impact isn't evenly spread across the economy. Some companies do better than others at withstanding the effects.

Inflation-hedged investments

Assets such as gold and real estate are considered traditional inflation hedges. These hard assets hold their value regardless of what happens to the currency and inflation.

Barrick Gold, for instance, could see some upside if inflation flares up. The value of gold tends to rise alongside inflation. Higher gold prices will broaden Barrick's margins and push its stock up.

Meanwhile, medical real estate investment trust (REIT) **NorthWest Healthcare REIT** could be a shield against inflation. Hard assets such as physical properties tend to retain their value over time, despite inflation. Medical centres and clinics should be even more robust.

Bottom line

We could face a spike in inflation this year. Protect your portfolio with allocations to gold and real estate.

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