Inflation Under Control: Should We Believe the Feds?

Description

Canada's headline inflation in September 2021 hit 4.4%, up from 4.1% in the prior month. Based on data from Statistics Canada, it was the fastest annual rise since February 2003. The Bank of Canada has kept inflation in check at the onset of the pandemic by lowering its key policy interest rate.

BOC wants to maintain inflation close to or at least 2% to support sustainable economic growth. However, the rate has gone up dramatically over the Feds' target range. Still, Bank of Canada Governor Tiff Macklem said recently, "I do want to assure Canadians that we are going to keep inflation under control."

Macklem added, "We have the tools, we have the mandate, and we will be adjusting our tools to bring inflation back to target." BOC intended to hike the interest rate in 2023. But now, with its inflation target missing the mark, the timeline has moved earlier to 2022.

Transitory issue

Despite six consecutive months during which inflation was higher than the central bank's target range of between 1% and 3%, Governor Macklem stresses that the issue is temporary or transitory. Economists, however, disagree with the rhetoric. Derek Holt, the **Bank of Nova Scotia's** (TSX:BNS)(NYSE:BNS) head of capital markets economics said, "This isn't transitory at all, in my opinion."

Mr. Holt adds that the situation is disturbing when it affects homes, grocery bills, cars, and other leading factors contributing to the inflation picture. **Toronto-Dominion Bank** Senior Economist James Marple said, "Lift-off may not come as early as markets are currently pricing, but the risks are certainly moving to sooner rather than later."

New timetable

The disagreement could be a matter of semantics because Macklem said, "I think transitory to economists means sort of not permanent." He added, "Maybe I don't know exactly what the right word is, but it's probably something like, you know, transitory but not short-lived."

Regarding the timing of the rate hike, Macklem intimates it could be sometime around the middle of next year, perhaps between April and September 2022.

Dividend hike of Big Banks

Canadian Big Banks have endured the headwinds, including the low-interest-rate environment. They increased provision for credit losses (PCLs) to unprecedented levels in 2020. The banks needed shock absorbers in case of massive loan defaults. Fortunately, the anticipated deterioration of credit quality didn't happen.

The Big Six ended Q2 fiscal 2021 with a collective $40 billion in excess common equity tier 1 (CET1) capital. On November 4, 2021, the Office of the Superintendent of Financial Institutions (OSFI) lifted the restrictions on dividend increases and share buybacks. Bloomberg Intelligence estimates the potential average dividend increase of Big Banks to be 18%.

Canada's third-largest bank pays the highest dividend (4.35%) among the giant lenders. The $101.33 billion bank had $5.2 billion in excess CET1 capital over the 11% industry floor (April 30, 2021). At $83.39 per share, BNS is up 27.08% year to date. The dividend king in the banking sector has a total return of 190,419.14% (16.68% compound annual growth rate in the last 48.95 years).

Eight rate increases

BNS' Derek Holt predicts that the Feds will increase interest rate four times in the back half of 2022 and four more will follow in 2023. He said that BOC's interest rate policy could be 2.25% when it's over.

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