1% Rate Hike: Has the Bank of Canada Lost its Mind?

Description

The U.S. Federal Reserve came into the limelight when it announced a 75-basis-point interest rate hike in May, creating waves that shook equity markets in the U.S. and Canada. The likes of such a significant interest rate hike by the U.S. Fed had not been seen since 1994.

The Bank of Canada (BoC) has also been raising benchmark interest rates to tame the runaway inflationary environment. After the recent-most hike by the U.S. Fed, Canadians feared we would see a similar jump in Canada. The BoC, however, announced a massive 100-basis-point interest rate hike, increasing benchmark rates by a full 1% to bring the total figure up to 2.5%.

The BoC's latest interest rate hike is the highest since 1998, and it has made borrowed capital considerably pricier. The impact on the Canadian economy will be significant, and everyone should rightfully be worried about what will happen now.

Why was there such a jump?

Central banks typically raise interest rates to keep inflationary environments in check. Recent years forced BoC to maintain historically low interest rates. The federal government also pumped liquidity into the economy through stimulus funds to help people as they struggled to deal with the pandemic's economic crunch. The U.S. government also took similar measures to hold the economy stable.

An unfortunate result of pumping liquidity and keeping interest rates low was letting inflation run riot in Canada and the United States. At writing, Canada's official inflation rate is 7.7%. South of the border, inflation crossed the 9.1% mark last month.

Many people might think that a 100-basis-point interest rate hike means that the BoC has lost its mind. However, these are the highest inflation rates the region has seen in decades. If the central banks do not take measures to control inflation, it could have devastating long-term effects on the economy.

Raising interest rates is the only way central banks can control inflation. By making it more expensive for consumers to borrow money, the drop in demand will let supply catch up. Slowing economic activity will decrease the disparity in supply and demand, gradually making things more affordable.

What can you do amid all the chaos?

Inflation has the tendency to be stubborn, despite aggressive interest rate hikes. It takes a while for the cost of everything to go down due to the effect of higher borrowing costs. Unfortunately, it also means more interest rate hikes as the year continues. Some analysts anticipate another 1% or at least a 0.75% hike in September.

Protecting your investment capital during times like this requires focusing on investing it in high-quality assets capable of weathering the storm. **Canadian Natural Resources** (TSX:CNQ)(NYSE:CNQ) is one such asset you can consider for this purpose.

Canadian Natural Resources is a $71.40 billion market capitalization senior oil and natural gas company. Headquartered in Calgary, it is one of Canada's most significant oil and gas producers. The company should see a substantial boost in its earnings due to higher energy prices throughout the year. It boasts a strong balance sheet and very little debt compared to many of its peers in the energy industry.

Foolish takeaway

Canadian Natural Resources stock trades for $61.09 per share at writing and boasts a juicy 4.91% dividend yield, making it qualify to be considered an undervalued stock. Its share prices are down by almost 30% since their May 2022 levels.

The company has already reduced a significant portion of its debt and will likely reduce it further in the coming months. If oil prices remain high in the next few months, the Canadian energy sector could see a significant upswing, making Canadian Natural Resources stock a steal at current levels, despite weakness in the broader economy.

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