January 2022 Financial Planning Email Update

Happy New Year!!

As we enter a new year many of us establish new goals for the upcoming year. To avoid the new year's resolution that is quickly forgotten it is recommended that all goals be written down as a positive affirmation, are specific, have a timeline and are reviewed often to establish the greatest likelihood of achievement. A comprehensive goal setting exercise can be found on our website www.ghafinancial.com (within the Process tab) which I recommend being completed annually. If you do not have access to the internet, we would be happy to supply this to you.

Canada Revenue Agency (CRA) has announced that Tuesday, March 1,2022 will be the deadline to make your 2021 RRSP contribution. Your RRSP limit is found on the Notice of Assessment sent by the CRA in the spring of 2021. Please note that any transfers or loans for RRSP contributions must be completed at least one week prior to the above deadline. Please note that the 2022 Tax Free Savings Account (TFSA) additional limit is $6,000 per Canadian resident aged 18 or older. The new TFSA lifetime maximum is now $81,500 which has been accumulating since 2009.

Amanda and I attended a virtual meeting with Francis Donald who is Manulife's Global Chief Economist and Strategist late November, 2021. Francis began by suggesting that at this point it is very difficult to forecast…the crystal ball is broken. The thing to do is acknowledge uncertainty by asking two key questions. Where is growth in the economy going and where is inflation going? This is thought of as the growth/inflation mix. What matters most is how the data comes in relative to expectations using the US Citi Economic Surprise Index and the US Citi Inflation Surprise Index. Right now, expectations are very low.

In forecasting 2022 there are four major unknowns today.

1. COVID19 is dominating the direction of the markets in two ways. Changing economic behaviour of consumers and business as well as government restrictions which will slow growth. China's zero tolerance policy will lockdown a factory with one case which has had a material impact on worldwide economic growth.
2. Supply Chain Disruptions. How long will they last? Due to change in our buying behaviour to things for our home. Port backlogs and labour shortages will prolong disruptions. This is creating high prices which may cause declining interest in buying by consumers.
3. Labour shortages with a drop in immigration and an increase in early retirement especially for women aged 55 and over who are electing to look after elderly parents and grandchildren. Today there is an increase in job openings and a decrease in hirings.

4. How will policy makers respond? The normal response is when inflation increases you must increase interest rates. The issue is that what is causing inflation (the above first three unknowns) will not change with increasing interest rates therefore will not be effective.

The following article "Brace for Impact: Interest Rates are Rising" was written by

William Robson, the chief executive officer of the C.D. Howe Institute in late December 2021. (https://www.theglobeandmail.com/business/commentary/article-brace-for-impact-rate-hikes-are-coming/).

"Bank of Canada governor Tiff Macklem, like U.S. Fed chairman Jerome Powell, is clearly starting to view continuing high inflation with concern. A change is coming in monetary policy. With demand outrunning supply, our central banks' policy interest rates need to rise – and may rise a lot.

Before COVID-19 triggered a monetary explosion, inflation in Canada and the United States had been so low for so long that most people could ignore it and ignore monetary policy as well. Inflation was reliably close to 2 per cent year after year. The Bank of Canada's overnight rate, its benchmark policy rate, and the U.S. equivalent, the Fed Funds rate, moved much less than they had when inflation was high and variable. How central bank policy rates affect spending and inflation became a question for technicians.

Now that it is a wider concern, it is time to refresh an old insight. Whether an interest rate is low or high depends on what potential borrowers and lenders expect. Suppose the going rate for a mortgage or a business line of credit is 2 per cent. If a slump knocks your house's value down or pummels your business's sales, 2 per cent can look scarily expensive. If a boom pushes your house's value up or boosts sales, the same 2 per cent can look laughably cheap.

The first situation was a concern after the 2008 financial crisis and again early in the pandemic. Expectations got so bleak that some people thought even a central bank policy rate of zero was too high. The second situation is a concern today. A recovering economy and high inflation are raising expectations about future values and sales. The 0.25 per cent target for the overnight rate the Bank of Canada just reconfirmed might once have looked high. Now it looks low.

Identifying a central bank rate that would be "just right" – consistent with steady growth and low inflation over time – is tough. A good start, though, is to think about the "real" interest rate – the return borrowers and lenders would pay or receive after allowing for inflation. We can subtract inflation from the bank's policy rate to get a real overnight rate, and look at past values for perspective on our current situation.

From the 1960s until the advent of the 2-per-cent target at the end of 1995, the average real policy rate – the difference between a nominal policy rate close to 7.9 per cent and

inflation above 5.2 per cent – was 2.6 per cent. From the end of 1995 until 2020, the average real policy rate – the difference between a nominal rate around 2.4 per cent and inflation around 1.8 per cent – was 0.6 per cent. Now, the difference between the 0.25 per cent policy rate and inflation yields a real rate that is way negative: more than 4 per cent below zero.

If potential borrowers and lenders thought the economy was collapsing, a real overnight rate that low might stabilize things. But the economy is on fire. A real overnight rate that low adds more fuel.

Former New York Fed president Bill Dudley is warning that U.S. inflation is so hot that cooling it may require a Fed Funds rate far higher than the market expects. The Bank of Canada has been less loose, and Canadian inflation is lower. But the bank's latest forecast showed it above target until late 2024, and subsequent numbers on inflation and job growth are adding to the upside risks.

Suppose inflation subsides to 3 per cent and containing it only requires a real policy rate typical of the post-1995 period. That still means raising the overnight rate to around 3.6 per cent. Suppose inflation runs at 4 per cent and containing it requires a real rate more typical of the higher-inflation 1960s, 1970s and 1980s. That means an overnight rate above 6 per cent. Suppose the new inflation agreement with the federal government softens the target, prompting a delay in tightening. When Canadians demand an end to the erosion of their money – as they eventually will – the overnight rate that is needed would be higher yet.

Even the mildest of these scenarios exceeds forecasters' predictions and market expectations. Hardly anyone expects an overnight rate above 2 per cent before the end of 2023. But loose monetary policy has contributed to high inflation, and it will take tighter policy to contain it. Investors, homeowners, businesses, and our big-borrowing governments need to get ready. Higher interest rates are coming."

Amanda and I are both qualified CERTIFIED FINANCIAL PLANNER® professionals at your service to assist in all areas of comprehensive financial planning including financial goal discovery, cash flow/budget analysis, retirement income planning, tax savings, estate planning, insurance needs analysis, investment planning, education saving planning, special purpose or major purchase planning.

I wish to thank you for your continued confidence and for the opportunity to serve you in all aspects of Financial Planning. As always, I will continue to keep in touch with you but if you have any questions or concerns, that you would like to discuss or review, please do not hesitate to contact either Amanda or I by email or by calling us at 519-894-2661 or toll-free at 1-800-716-5538.

Have a great day!

Respectfully Yours,

*Gary*

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