Cidel Asset Management

Inflation, Inflation, Inflation

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Q&A with Arthur Heinmaa, Cidel's Chief Investment Officer

Inflation has been prominent in the headlines and is a key topic of conversation as the world emerges from lockdowns and global economies are gaining momentum. I sat down with Arthur Heinmaa, Cidel's Chief Investment Officer, to get his perspective and insight into the various components that drive inflation and Cidel's outlook moving forward.

Karl Berger, Senior Wealth Consultant and Director (KB): Thank you for joining me today, Arthur. Inflation is a key concern for many individuals and it seems we are continuously reading projections and potential implications this environment may bring. How do you recommend investors think about inflation?

Arthur Heinmaa, Chief Investment Officer (AH): People tend to think of inflation as binary – we are either in an inflationary period or we are not – where everything is anchored around a target of 2% and any move on either side has a magnified response. It is much more accurate, however, to view it as a continuum. In Canada, inflation is largely tracked by the Consumer Price Index (CPI), which measures the average price of a basket of goods and services over time.

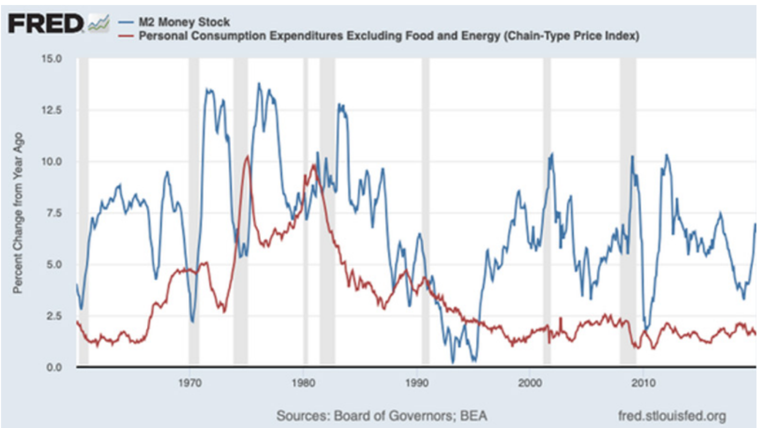
KB: Can you speak to why price levels in the past year appear to have increased significantly and what this means for an inflationary environment?

AH: It is important to frame your analysis. For example, if the price of a night in a hotel in 2019 was $400, but due to significantly decreased demand in 2020 it only cost $190, but we now see prices back to $400, the increase seems substantial. However, the price is simply returning to, not exceeding, previous levels. Looking at the graph below, we see depressed prices in 2020 but the current level is just a return to the pre-pandemic level.

Source: Bloomberg, BCOMRB Index

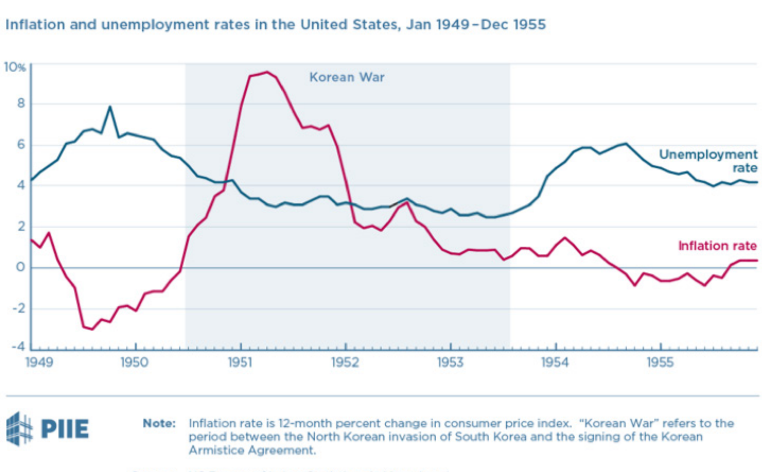
KB: The role and magnitude of money supply in the economy is typically a key indicator of inflation. What trends are being seen in this area?

AH: Money supply has been on a march upwards, especially in the last few years, but we have not seen a corresponding spike in inflation rates. It would not be accurate to say that money supply increases are automatically positively correlated with inflation. As illustrated in the graph below, in the early 2000s when all conditions were poised for an inflationary environment, inflation failed to materialize. The velocity of money, which measures the frequency at which one unit of currency is used to purchase domestically produced goods and services, is also interesting to look at - if the money supply is sitting idle and not being circulated throughout the economy (low velocity), inflation is unlikely to emerge.



KB: What is Cidel's outlook on inflation?

AH: Due to the uncertainty of last year and with many businesses forced to halt operations to a large extent, Cidel's view is that inflation will normalize and is unlikely to persist for several years. The Federal Open Market Committee has similarly stated that after the transitory effects fade, expected inflation is likely to ease. There are some shorter term factors such as supply chain bottlenecks and input shortages that may persist and could put upward pressure on prices past the end of the year. But, when looking back on the inflation effects of the Korean War as illustrated below, we see an initial uptick but normalization soon after. We expect to see a similar return to trend.



Population growth is also an important factor in inflation trends. More people, simply put, means more consumption. We are seeing low population growth rates and a decrease in world merchandise trade, forecasting slower economic growth.

As mentioned previously, year-over-year price level changes make inflation look more significant in the near term. We think that even businesses that are able to raise prices now due to pent up demand from the pandemic will not likely succeed in serially raising prices in the months and years to come. As such, Cidel expects that the current inflation readings will largely subside as we move into 2022.