Bank of Canada hangs on to hawkish bias

The BoC maintained rates on hold as expected, but signalled more hikes are possible while flagging upside risks to inflation. However, new projections have confirmed the growth outlook has deteriorated. Taking that into account, and evidence that tightening is working to curb demand and inflation, we don't expect more hikes in Canada

Bank of Canada building in Ottawa

BoC still worried about inflation

The Bank of Canada left the overnight rate at 5% as widely expected in the wake of a surprise contraction in economic growth in the second quarter, a lacklustre performance since then and inflation coming in softer than anticipated in September. But with the jobs market remaining tight and the sense that this could mean inflation remains sticky, the BoC have left the door ajar for further rate hikes if required.

With progress towards price stability being regarded as "slow" the BoC aren't expecting inflation to return to 2% until 2025. They will need to see "downward momentum in core inflation" and softening in inflation expectations, wage growth and corporate pricing behaviour before they can relax.

Bank of Canada October forecasts

	2023	2024	2025
GDP	↓ 1.2 (1.8)	↓ 0.9 (1.2)	↑ 2.5 (2.4)
CPI inflation	↑ 3.9 (3.7)	↑ 3.0 (2.5)	↑ 2.2 (2.1)

Source: Bank of Canada, ING

Numbers in brackets from July's Monetary Policy Report

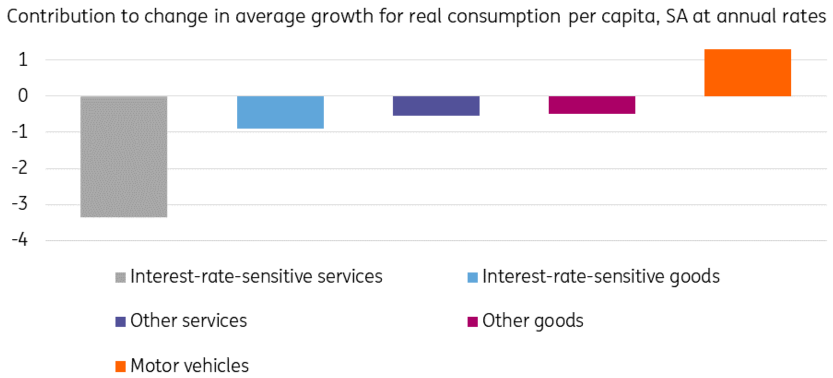
We don't expect more hikes

We don't think additional rate hikes will happen though. As the BoC admits, employment growth is rising more slowly than the labour force and job vacancies are slowing. This should ease wage concerns and contribute to more labour market slack.

Meanwhile, the structure of the residential mortgage market means that with most people facing an adjustment to their borrowing rate on a three-to-five-year basis (rather than 30 years in the US), more households will be increasingly exposed to the lagged effects of BoC rate rises. This should all help to weigh on activity and dampen price pressures, potentially opening the door for rate cuts in mid-2024.

In the Monetary Policy Report released today, the BoC reported how the rate-sensitive categories are experiencing the greatest slowdown in consumption due to the effect of tighter monetary policy (chart below).

Higher interest rates dampening consumption in Canada



Source: Bank of Canada, ING

Market reaction: growth in focus

Markets were pricing in around 10bp of tightening by March ahead of the BoC announcement, and were fully focused on the new economic projections to gauge the likelihood of further moves. It is clear from the statement that the Governing Council wanted to reiterate its hawkish bias, as it stressed how the improvements on the disinflation side are insufficient and flagged fresh upside risks for prices.

However, the downward revisions in the growth forecasts – paired with the evidence included in the MPR that higher rates are effectively slowing inflation – are reasonably doubtful the BoC will actually raise rates further from this point.

USD/CAD rallied briefly after the release, in our view due to the fact that a hawkish hold was expected but the growth downward revisions may have exceed some expectations. Still, as Governor Tiff Macklem is in the middle of his press conference, USD/CAD is back slightly below 1.3800. We continue to see upside risks for the pair in the very near term mostly on the back of USD strength, while targeting 1.36 for year-end.

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