

24 October 2018
Article

Bank of Canada hikes and hawkish tone suggests more to come

The central bank of Canada raised rates by 25bp today, but the question now is what will their 2019 tightening path look like? Downside risks linger, but unless they escalate, we see two more hikes coming next year

Contents

- Divergence between BoC's and the Fed's path
- We stick with our base case

As widely expected, the Bank of Canada hiked the policy rate by 25 basis points bringing it to 1.75%. Although we expected to see a more dovish tone given the poor September CPI print of 2.2% year on year -considerably undershooting the 2.6% YoY consensus, the BoC remained upbeat with the view that the limited spare capacity in the economy will continue to put pressure on prices. This is why it looks set to continue on its tightening path.

Core inflation is the key variable for policy decisions, and despite the slight dip in September, the three main measures still averaged the BoC's 2% target. As long as core data floats around this level, we expect further tightening in 2019. We predict two hikes in 1Q19 and 3Q19, taking the policy rate towards the lower end of the BoC's estimate of the nominal neutral rate (2.5%-3.5%, based on at-target inflation).

If lingering downside risks subside, then a third hike next year isn't entirely out of question, particularly, if we see a pick-up in wage pressures on the back of labour shortages, as was hinted at in the latest [BoC Business Outlook Survey](#).

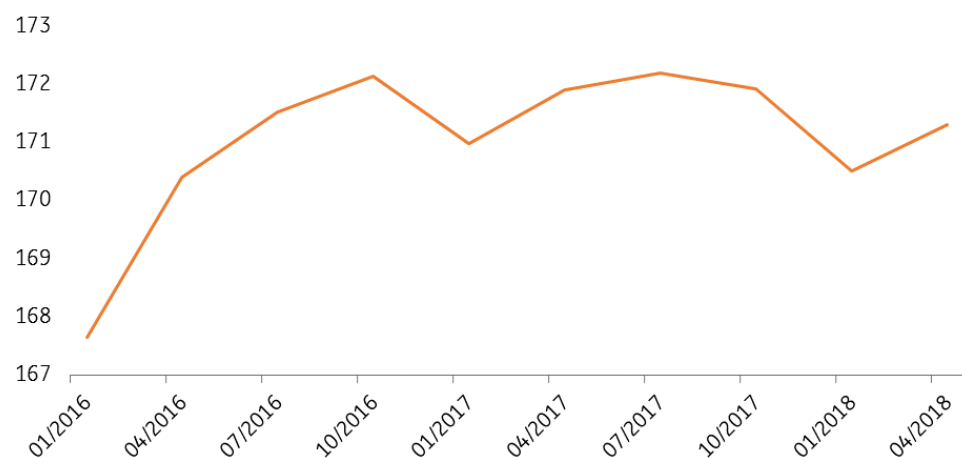
Divergence between BoC's and the Fed's path

This is slightly slower than the Fed's predicted tightening path, where we see four more hikes from now until the end of 2019. But considering the Canadian economy hasn't received the huge fiscal boost the US has, along with potential downside risks associated with weaker wage growth, slowing house prices and the persistently large household/debt ratio, a slight divergence between the two central banks isn't a surprise.

Going into next year, any escalation in these downside risks could see the central bank having to rethink their tightening path, although today's hawkish statement makes this look less likely.

Canada's household debt is a potential risk to the economy

% of Debt to Gross Income



Source: Macrobond

We stick with our base case

Given the Bank of Canada still expects inflation to be at, or above, its target, and the growth outlook is still looking reasonable, we stick with our base case of two rate hikes in 2019.

James Knightley

Chief International Economist

+44 20 7767 6614

james.knightley@ing.com

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("**ING**") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group NV and its subsidiary and affiliated companies).* The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. The producing legal entity ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is subject to limited regulation by the Financial Conduct Authority (FCA). ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.