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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

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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).

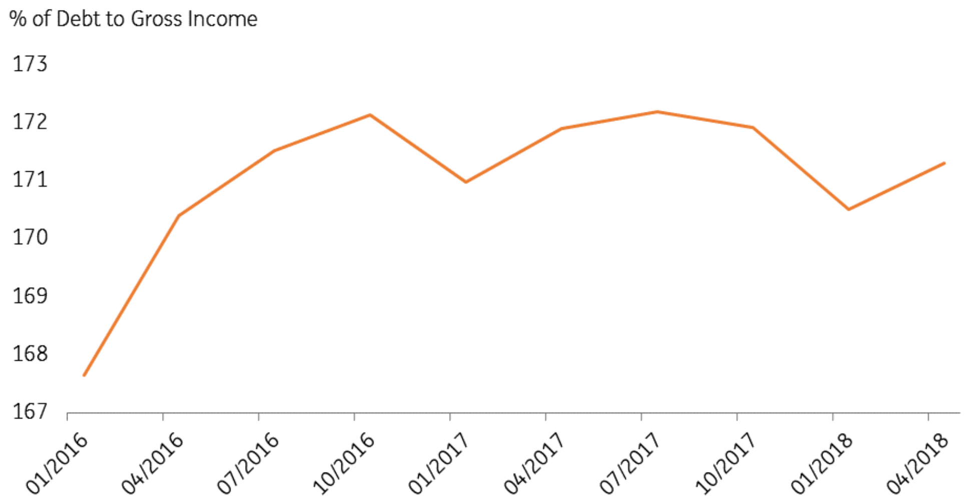
If lingering downside risks subside, then a third hike next year isn't entirely out of question, particularly, if we see a pick-up in wage pressures on the back of labour shortages, as was hinted at in the latest BoC Business Outlook Survey.

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



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.

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