

## Bank of Canada hikes by a further 75bp

The Bank of Canada continues to worry about excess demand and elevated inflation expectations despite recent weaker inflation and GDP readings. Further hikes are coming, but likely at a slower pace with the policy rate set to hit 4% before year-end. There is some room for a hawkish repricing, but benefits for CAD should not be seen in the near term

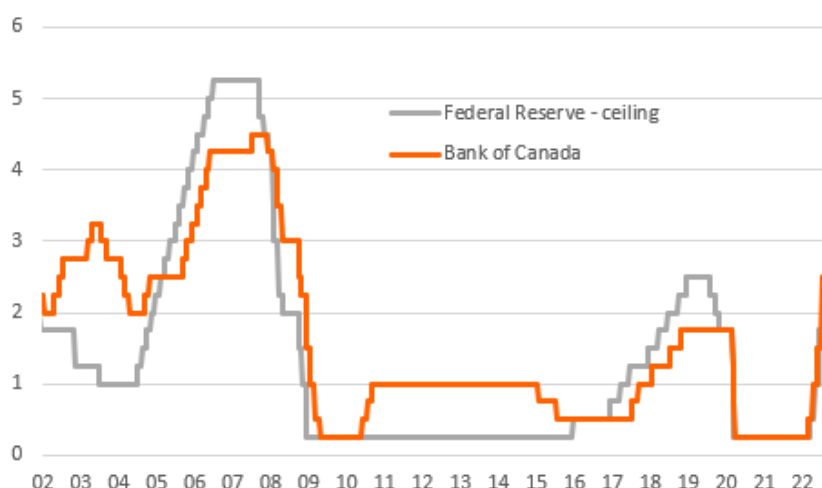


### BoC raises rates to 3.25%

The Bank of Canada (BoC) has raised its policy rate by 75bp to 3.25%, as was widely expected. This follows a surprise 100bp hike in July and brings the cumulative policy tightening to 300bp since February.

While acknowledging that inflation slowed to 7.6% last month and that second-quarter GDP growth was less than expected at 3.3%, the BoC argues that the economy continues to experience “excess demand” and a tight labour market. Moreover, while GDP did undershoot forecasts, this was more trade-related and residential construction-related with consumer spending and business investment looking “very strong”. Meanwhile, core inflation continues to rise with the data indicating a “further broadening of price pressures”.

## BoC versus Federal Reserve policy rates



Source: Macrobond, ING

### 4% expected by year end

The BoC also remains deeply nervous about elevated inflation expectations, which if persist creates a “greater risk that elevated inflation becomes entrenched”. Consequently, the BoC “judges that the policy interest rate will need to rise further”.

The policy rate is now above the “neutral rate”, assumed to be in the 2-3% range by the Bank of Canada. But with inflation well above target, the economy continuing to experience “excess demand”, and policy only mildly restrictive, we expect a further 75bp of hikes by year-end. This will take the policy rate to 4% and we believe this will mark the peak. A deteriorating global outlook and signs of weakness in the housing market, which will be intensified by additional rate hikes, are likely to lead to a slowdown in Canadian economic activity. With inflation also expected to gradually subside through 2023, we are looking for BoC rate cuts in late 2023.

### CAD: Limited benefits from a hawkish BoC in the near term

Today's BoC move and rhetoric were largely in line with the market's expectations, and USD/CAD is trading only slightly lower following the announcement after a strong session for the pair as oil prices remained pressured. We see some room for further hawkish repricing in the CAD swap curve from now on as our call for 75bp worth of extra tightening (so rates being hiked to 4.0%) is above the peak rate expected by markets (3.8%).

Indeed, the positive implications from a hawkish BoC are nearly absent in USD/CAD price action at the moment, as external woes (oil, risk sentiment, USD strength) are dominating. This may continue to be the case in the near term, but we continue to see room for a return to 1.25 in USD/CAD by early next year thanks to the loonie's rate and fundamental attractiveness, along with some weakening of USD.

## Author

### James Knightley

Chief International Economist, US

[james.knightley@ing.com](mailto:james.knightley@ing.com)

### Francesco Pesole

FX Strategist

[francesco.pesole@ing.com](mailto:francesco.pesole@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 N.V. 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. 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 authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. 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.

Additional information is available on request. For more information about ING Group, please visit [www.ing.com](http://www.ing.com).