

Bank of Canada hikes interest rate by 25bp

The Bank of Canada has raised interest rates by 25bp. It acknowledged the uncertainty caused by Russia's invasion of Ukraine, which could weaken growth and boost inflation. Nonetheless, Canada's economy is likely to be one of the more insulated from damaging economic effects and we look for five further hikes this year



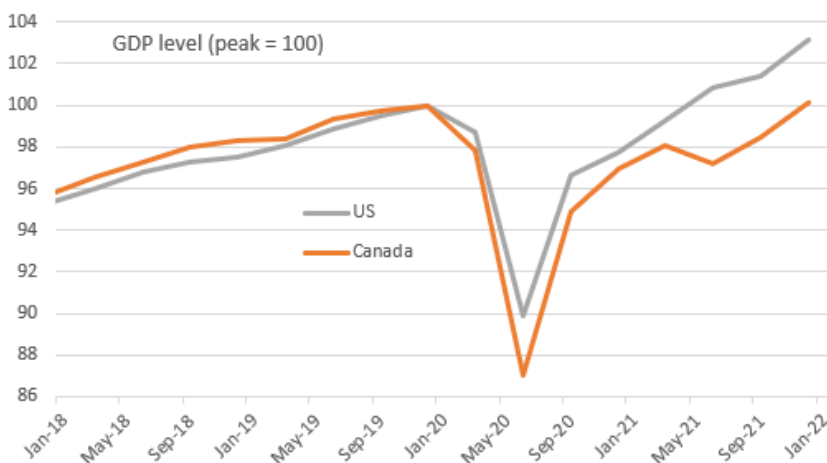
Bank of Canada starts to tighten policy

As widely expected we have a 25bp interest rate hike from Bank of Canada (BoC), taking the target for the overnight rate to 0.5%. It is keeping the balance sheet stable with all maturing assets continuing to be reinvested.

The bank acknowledged that Russia's invasion of Ukraine is a "major new source of uncertainty" that will "add to inflation around the world... [and] could weigh on global growth". Nonetheless the strong domestic growth story provides support with the lifting of Covid restrictions meaning "growth is now looking more solid than previously projected". As the chart below shows, the economy has now recovered all of the lost output caused by the pandemic while employment is

actually above pre-pandemic levels. So while the economy hasn't grown quite as vigorously as in the US, the labour market has actually outperformed.

Canada vs US size of the real economy (4Q19 = 100)

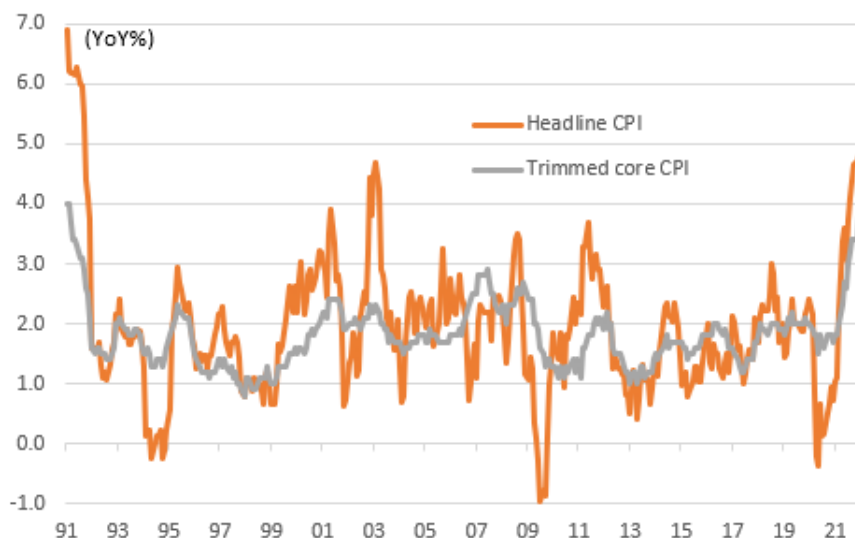


Source: Macrobond, ING

More rate hikes are coming and quantitative tightening will be utilised

Inflation, which is already at 30-year highs, is also now expected to be higher in the near term than projected in January and the risk is that inflation expectations "could drift upwards". Consequently the Bank of Canada "expects interest rates will need to rise further" and this will be complemented by "quantitative tightening" via ending the reinvestment phase of its bond holdings.

Canada inflation rates (YoY%)



Source: Macrobond, ING

Russia risks are high, but Canada is in a strong position

The BoC did not provide specific guidance due to the uncertainty and economic implications from "the unprovoked invasion of Ukraine by Russia". We are looking for six rate hikes from the BoC in total this year (so five more to come). Canada is relatively insulated due to being a major commodity producer and having far less direct economic and financial linkages with Russia and Ukraine. Markets are currently pricing for another 5.5 hikes this year.

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