Bank of Canada retains its hawkish bias

The BoC kept rates unchanged as expected, but had to recognise that rates are “clearly restraining spending” and that disinflation is happening at a faster pace. However, that was not enough to drop the threat of another hike if necessary. While this is generally good news for CAD, external factors (US data in particular) remain much more relevant

Bank of Canada building in Ottawa

Sticking to the tightening threat

The Bank of Canada kept rates unchanged at 5.0% today, as widely expected. The policy statement noted that “higher interest rates are clearly restraining spending: consumption growth in the last two quarters was close to zero, and business investment has been volatile but essentially flat over the past year”. Incidentally, the BoC recognised the faster pace on the disinflation front, dropping the reference to “slow” progress on inflation.

Those considerations would have likely led to a more dovish tone on the policy outlook as a consequence, but the BoC decided to reiterate the threat of more monetary policy tightening instead: “Governing Council is still concerned about risks to the outlook for inflation and remains prepared to raise the policy rate further if needed”. The concerns about the inflation outlook come not only from potential external shocks (e.g. energy prices), but also from a resiliently tight domestic labour market, as confirmed by last week's strong jobs figures.

We are still convinced that the BoC will not tighten policy further given the deterioration of the economic outlook and our expectations for a steady decline in Canadian's inflation. However, there is a likely intent to fight the ongoing dovish repricing of rate expectations in Canada, and that means the BoC out-of-meeting commentary may be careful to send dovish messages to the market before the January meeting, when new economic projections will be released.

CAD still too reliant on US data

From a market perspective, the reiteration of the hawkish bias by the Bank of Canada is positive news for CAD, although the acknowledgement of faster inflation decline and the strong impact of tight monetary conditions on the economy have offset the impact on the loonie, which is holding steady after the announcement.

Despite the BoC's reluctance to pivot to a more dovish stance, the loonie remains highly affected from a deterioration in US data, to which it has the highest correlation in G10. In the short term, the last bits of evidence of US activity resilience may support CAD – especially in the crosses – but we expect the worsening of US (as well as Canadian) growth sentiment next year to make CAD less appealing than other risk-sensitive currencies like the antipodeans and Scandies.

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