

## Bank of Canada: to hike or not to hike?

Markets are torn when it comes to the chances of a Bank of Canada rate hike at its next meeting. We think it shouldn't be completely ruled out, although there are risks – most notably Nafta



Source: Bank of Canada

### Nafta talks trudge on

Nafta talks, which were initially set to end in December 2017, are continuing to trudge on with the next round of negotiations rumoured to take place in July. Canadian Foreign Minister Chrystia Freeland has said that she still thinks a Nafta deal is possible, despite the recently imposed US steel and aluminium tariffs. These tariffs have been a key source of contention (as shown by comments made at the G7 summit) between Canadian Prime Minister Justin Trudeau and US President Donald Trump. However, all three countries seem keen to continue pressing on with the reworking of the agreement.

### Sticking points

On Tuesday 19 June, President Trump optimistically mentioned that Nafta progress was being made, although he still held out for the option of bilateral agreements should they be needed.

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The key remaining sticking points for Nafta continue to be auto content rules, the 'sunset clause', government procurement, agricultural laws and dispute settlements. Our base case is that a Nafta deal will be made, although of course the big question is 'when'.

## Growth and inflation

In terms of the Canadian economic environment, growth moderated in the first quarter but still remains robust and in line with the Bank of Canada's forecasts. Meanwhile, inflation is set to continue its bout of strength - markets are expecting May's headline figure (released tomorrow) to come in at 2.5% year-on-year, riding the wave of higher oil prices. Core inflation has also experienced a notable uptick, with the latest readings averaging out at the BoC's 2% target. Assuming this trend continues, the Bank will need to make a choice between maintaining its price stability mandate and offsetting ongoing trade uncertainty.

### Odds of a rate hike

The next Bank of Canada meeting is due to take place on 11 July, the first gathering since it dropped its cautious tone back in May. Markets are pricing in a 67% chance of a rate hike, down slightly from around 80% earlier in June. Although the odds of a July hike are falling we don't think it should be completely ruled out yet. When making its decision, Friday's inflation and next week's GDP data are likely to be watched closely by the 'data-dependant' Bank - as of course will be the Nafta newsflow.

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