

Canada: Delaying the inevitable

An October policy rate change is looking unlikely as the Bank of Canada waits to see how the economy performs in the wake of the previous two rate hikes – but more tightening is coming...



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A needed pause?

The previous two Bank of Canada (BoC) meetings saw interest rates increase 25bp, leaving the policy rate at 1%, in a full reversal of the 2015 cuts. However, with inflation remaining below the 2% target the BoC are likely to pause and observe the impact of a stronger CAD, new macro prudential housing measures (due to be put in place in January), NAFTA talks and the interest rate increases on the economy.

1%

Current Policy Rate

up 50bp over the last two BoC meetings

What do markets think?

The most recent BoC public addresses have had a slightly less hawkish tone. Governor Stephen Poloz has emphasized the BoC's 'data dependant' approach highlighting that there is 'no pre-determined path for interest rates'. Deputy Governor Timothy Lane also underlined the sensitivity of the economy to a stronger CAD and increased interest rates.

All of this considered, a hike is looking unlikely in tomorrow's meeting, reflected by the softening in CAD – down nearly 3.5% since early September. However, markets are fully pricing in a January hike and another hike by July 2018, a slightly more aggressive stance to ours, in terms of timing, rather than magnitude.

Our view

We expect the Bank of Canada to keep their policy rate on hold at 1% through to year end with two further 25bp rate hike in 2018. However, should the US pull out of NAFTA we would remove one of our forecasts due to the uncertainty it would create and the impact it would have on economic activity. But the weaker Canadian dollar would provide a slight offset in the BoC's thinking.

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