Canada rate hikes: Three's a crowd?

More GDP data this Friday, could we see another rate rise soon?

Source: Bank of Canada

Can the growth be sustained?

Following the first half of the year's exceptional performance, the first Canadian GDP data of 2H17 will be watched closely as investors wonder whether rates could be raised for the third consecutive time. September's policy meeting saw a second consecutive rate hike from the Bank of Canada (BoC), where the overnight rate was increased another 25bp to 100bp, following strong and surprising 2Q17 growth of 4.5% (up from 3.7% in 1Q17).

Growth is becoming more self-sustaining and broad-based

The BoC believes that future growth will be led by business investment. June's growth figures came in at 0.3% MoM and 4.3% YoY and the consensus is expecting July's MoM and YoY figures to slow to 0.1% and 3.9%, respectively. Growth is expected to moderate during the second half of the year and today's monthly figure allows us to see whether this has begun.

1%

Policy Rate

up 25bp from the September hike

The inflation dilemma

Governor Poloz (pictured), on 27 September, highlighted that *"as the expansion continues, we (the BoC) will continue to manage the evolving risks to the inflation outlook"*, where past years has seen inflation consistently hit below the 2% target. The temporary factors held accountable for this, including weakened food and electricity prices, are expected to dissipate, with inflation estimated to slightly overshoot its target in early 2019. Nonetheless, changes in the exchange rate have caused some uncertainty around this.

What could the future look like?

As said by Canada's finance minister, Bill Morneau, interest rates "*are still at pretty historically low numbers"* and that the two hikes have "r*eally just taken the edge off*" reductions that were put in place after the oil price shocks. This was emphasised again by Poloz who said "at a minimum, that additional stimulus is no longer needed. But there is no predetermined path for interest rates from here".

> *At a minimum, additional stimulus is no longer needed*

The BoC's data-driven and forward-looking stance combined with low inflation and other stressed risks, notably the CAD, which hit a 2-year high against USD after the September hike, the NAFTA trade deal and high household debt, have led Investors to believe that a third consecutive hike in October is unlikely. However, markets have priced in a January hike as almost certain.

We believe that the BoC will adopt a more prudent approach and keep its policy rate on hold at 1% through to year end with two further rate hikes taking place in 2018. At this stage there seems little need for an aggressive series of hikes, with the BoC likely to take a cautious approach, allowing it to assess the impact of its actions given the risks they have clearly outlined.

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