

Hawkish hold from the Bank of Canada, but we think rates have peaked

The BoC left the policy rate at 5% but warned that with inflation pressures remaining elevated it could yet hike again. We don't think they will need to as high borrowing exposure and lagged effects of policy tightening increasingly weigh on an economy that is already showing some cracks. The negative implications for CAD are, however, limited



Bank of Canada building in Ottawa

BoC leaves the door open for more

Having resumed hikes in June and July following a pause since January, the Bank of Canada opted to leave interest rates unchanged today at 5%. This was the widely expected outcome with just two of 30 or so economists expecting a hike and financial markets barely pricing 2bp of potential tightening following data showing the Canadian economy contracted in the second quarter, the manufacturing PMI moved deeper into negative territory and the unemployment rate crept higher.

This was acknowledged by the BoC with the accompanying statement recognising that the economy has "entered a period of weaker growth" and that labour market tightness "has continued to ease gradually". Yet inflation remains well above the BoC's target and the statement

mentioned "broad based" pressures, with rising gasoline prices meaning headline inflation is likely to stay higher than the BoC was forecasting in the near term. As such, we have a hawkish hold with the BoC prepared to hike again 'if needed". We think they won't need to and rates have peaked at these levels as high exposure to borrowing and the lagged effects of monetary policy tightening become increasingly apparent.

CAD steady after the announcement

The loonie was little changed against the dollar after the Bank of Canada announcement today. However, CAD is trading firmer than most other G10 pairs as strong ISM figures out of the US sent USD higher against most pro-cyclical currencies.

The CAD OIS curve after the meeting shows markets are pricing in around 10bp of tightening by the BoC, meaning that if we are right and the Bank does not hike rates again, the repricing lower in Canadian rate expectations should not materially hit the loonie. USD/CAD has plenty of room to correct on the back of rate-gap and commodity dynamics, but solid US activity data is likely to keep the pair supported in the near term.

Author

James Knightley

Chief International Economist, US

james.knightley@ing.com

Francesco Pesole

FX Strategist

francesco.pesole@ing.com

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies)*. The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit www.ing.com.