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.

Authors

James Knightley
Chief International Economist, US
james.knightley@ing.com

Francesco Pesole
FX Strategist
francesco.pesole@ing.com