

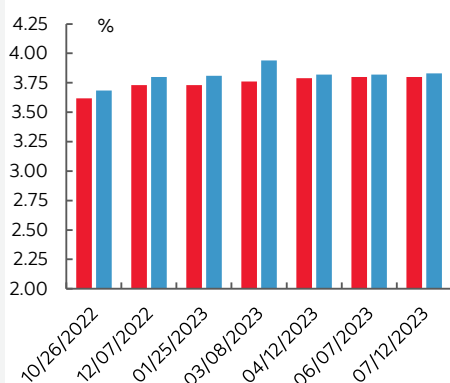
Contributors

Derek Holt

VP & Head of Capital Markets Economics
Scotiabank Economics
416.863.7707
derek.holt@scotiabank.com

Chart 1

Bank of Canada OIS Implied Policy Rate



Sources: Scotiabank Economics, Bloomberg.

Doves Repairing Divots as the BoC Didn't Pivot

- **BoC hiked 75bps as expected...**
- **...and retained guidance toward further rate hikes**
- **Bonds were slightly caught off guard hoping for a dovish pivot they didn't get**
- **We expect another +50bps in October with a full set of fresh information**

While the Bank of Canada largely met my expectations, its actions were taken a touch more hawkishly by markets as some were positioned for a somewhat more dovish spin. They didn't get that at all and so the two-year Canada yield backed up by about 4bps and the 5-year yield increased by about 4bps. USDCAD was little changed in the aftermath. Chart 1 shows a slight rise in meeting pricing pre-statement (red) and post-statement.

First, the BoC hiked its overnight rate by 75bps to 3.25% which brings cumulative rate hikes to 300bps since March. That part was fully priced going in although there was the risk they could have gone by more or less.

Second, the statement retained hike guidance and was very clear about this:

"Given the outlook for inflation, the Governing Council still judges that the policy interest rate will need to rise further."

The data dependent aspect of this guidance was similar to prior statements.

"As the effects of tighter monetary policy work through the economy, we will be assessing how much higher interest rates need to go to return inflation to target."

A few of the details also worked against more dovish takes on what they might have done but did not. For example, the Governing Council is looking through the small deceleration in headline inflation and remains more focused upon rising and broadening core inflation while expressing ongoing concern toward unmoored inflation expectations:

"However, inflation excluding gasoline increased and data indicate a further broadening of price pressures, particularly in services. The Bank's core measures of inflation continued to move up, ranging from 5% to 5.5% in July. Surveys suggest that short-term inflation expectations remain high. The longer this continues, the greater the risk that elevated inflation becomes entrenched."

Governing Council also looked through the fact that Q2 GDP growth was a little less strong than they had forecast in the July MPR and did so by emphasizing the domestic details:

"While this was somewhat weaker than the Bank had projected, indicators of domestic demand were very strong—consumption grew by about 9½% and business investment was up by close to 12%."

I should also note that balance sheet plans remain on autopilot for now. No one seriously expected that to change today and I don't think they'll taper full roll-off of maturing GoC bonds any time soon just to accommodate issuance pressures.

Overall the short and sweet statement buys time for a fuller reassessment on October 26th. We expect another 50bps hike to 3.75% at that time and incoming information between now and then may further inform the likely bias. A full Monetary Policy Report including fresh forecasts will be delivered and the BoC will issue Q3 surveys of business and consumer attitudes including inflation expectations on October 17th.

Please see the attached statement comparison, albeit one that is less useful when comparing non-MPR statements like today's to fuller MPR-statements like the previous one in July. SDG Rogers' speech headlines arrive at 11:25amET with a 1pmET presser.

September 7, 2022

RELEASE DATE: September 7, 2022

The Bank of Canada today **increased its target for the overnight rate to 3¼%**, with the Bank Rate at 3½% and the deposit rate at 3¼%. The Bank is also continuing its policy of quantitative tightening.

The global and Canadian economies are evolving broadly in line with the Bank's July projection. The effects of COVID-19 outbreaks, ongoing supply disruptions, and the war in Ukraine continue to dampen growth and boost prices.

Global inflation remains high and measures of core inflation are moving up in most countries. In response, central banks around the world continue to tighten monetary policy. Economic activity in the United States has moderated, although the US labour market remains tight. China is facing ongoing challenges from COVID shutdowns. Commodity prices have been volatile: oil, wheat and lumber prices have moderated while natural gas prices have risen.

In Canada, CPI inflation eased in July to 7.6% from 8.1% because of a drop in gasoline prices. However, inflation excluding gasoline increased and data indicate a further broadening of price pressures, particularly in services. The Bank's core measures of inflation continued to move up, ranging from 5% to 5.5% in July. Surveys suggest that short-term inflation expectations remain high. The longer this continues, the greater the risk that elevated inflation becomes entrenched.

The Canadian economy continues to operate in excess demand and labour markets remain tight. Canada's GDP grew by 3.3% in the second quarter. While this was somewhat weaker than the Bank had projected, indicators of domestic demand were very strong – consumption grew by about 9½% and business investment was up by close to 12%. With higher mortgage rates, the housing market is pulling back as anticipated, following unsustainable growth during the pandemic. The Bank continues to expect the economy to moderate in the second half of this year, as global demand weakens and tighter monetary policy here in Canada begins to bring demand more in line with supply.

Given the outlook for inflation, the Governing Council still judges that the policy interest rate will need to rise further. Quantitative tightening is complementing increases in the policy rate. **As the effects of tighter monetary policy work through the economy, we will be assessing how much higher interest rates need to go to return inflation to target.** The Governing Council remains resolute in its commitment to price stability and will continue to take action as required to achieve the 2% inflation target.

RELEASE DATE: July 13, 2022

The Bank of Canada today increased its target for the overnight rate to 2½%, with the Bank Rate at 2¾% and the deposit rate at 2½%. The Bank is also continuing its policy of quantitative tightening (QT).

Inflation in Canada is higher and more persistent than the Bank expected in its April Monetary Policy Report (MPR), and will likely remain around 8% in the next few months. While global factors such as the war in Ukraine and ongoing supply disruptions have been the biggest drivers, domestic price pressures from excess demand are becoming more prominent. More than half of the components that make up the CPI are now rising by more than 5%. With this broadening of price pressures, the Bank's core measures of inflation have moved up to between 3.9% and 5.4%. Also, surveys indicate more consumers and businesses are expecting inflation to be higher for longer, raising the risk that elevated inflation becomes entrenched in price- and wage-setting. If that occurs, the economic cost of restoring price stability will be higher.

Global inflation is higher, reflecting the impact of the Russian invasion of Ukraine, ongoing supply constraints, and strong demand. Many central banks are tightening monetary policy to combat inflation, and the resulting tighter financial conditions are moderating economic growth. In the United States, high inflation and rising interest rates are contributing to a slowdown in domestic demand. China's economy is being held back by waves of restrictive measures to contain COVID-19 outbreaks. Oil prices remain high and volatile. The Bank now expects global economic growth to slow to about 3½% this year and 2% in 2023 before strengthening to 3% in 2024.

Further excess demand has built up in the Canadian economy. Labour markets are tight with a record low unemployment rate, widespread labour shortages, and increasing wage pressures. With strong demand, businesses are passing on higher input and labour costs by raising prices. Consumption is robust, led by a rebound in spending on hard-to-distance services. Business investment is solid and exports are being boosted by elevated commodity prices. The Bank estimates that GDP grew by about 4% in the second quarter. Growth is expected to slow to about 2% in the third quarter as consumption growth moderates and housing market activity pulls back following unsustainable strength during the pandemic.

The Bank expects Canada's economy to grow by 3½% in 2022, 1¾% in 2023, and 2½% in 2024. Economic activity will slow as global growth moderates and tighter monetary policy works its way through the economy. This, combined with the resolution of supply disruptions, will bring demand and supply back into balance and alleviate inflationary pressures. Global energy prices are also projected to decline. The July outlook has inflation starting to come back down later this year, easing to about 3% by the end of next year and returning to the 2% target by the end of 2024.

With the economy clearly in excess demand, inflation high and broadening, and more businesses and consumers expecting high inflation to persist for longer, the Governing Council decided to front-load the path to higher interest rates by raising the policy rate by 100 basis points today. **The Governing Council continues to judge that interest rates will need to rise further, and the pace of increases will be guided by the Bank's ongoing assessment of the economy and inflation.** Quantitative tightening continues and is complementing increases in the policy interest rate. The Governing Council is resolute in its commitment to price stability and will continue to take action as required to achieve the 2% inflation target.

This report has been prepared by Scotiabank Economics as a resource for the clients of Scotiabank. Opinions, estimates and projections contained herein are our own as of the date hereof and are subject to change without notice. The information and opinions contained herein have been compiled or arrived at from sources believed reliable but no representation or warranty, express or implied, is made as to their accuracy or completeness. Neither Scotiabank nor any of its officers, directors, partners, employees or affiliates accepts any liability whatsoever for any direct or consequential loss arising from any use of this report or its contents.

These reports are provided to you for informational purposes only. This report is not, and is not constructed as, an offer to sell or solicitation of any offer to buy any financial instrument, nor shall this report be construed as an opinion as to whether you should enter into any swap or trading strategy involving a swap or any other transaction. The information contained in this report is not intended to be, and does not constitute, a recommendation of a swap or trading strategy involving a swap within the meaning of U.S. Commodity Futures Trading Commission Regulation 23.434 and Appendix A thereto. This material is not intended to be individually tailored to your needs or characteristics and should not be viewed as a “call to action” or suggestion that you enter into a swap or trading strategy involving a swap or any other transaction. Scotiabank may engage in transactions in a manner inconsistent with the views discussed this report and may have positions, or be in the process of acquiring or disposing of positions, referred to in this report.

Scotiabank, its affiliates and any of their respective officers, directors and employees may from time to time take positions in currencies, act as managers, co-managers or underwriters of a public offering or act as principals or agents, deal in, own or act as market makers or advisors, brokers or commercial and/or investment bankers in relation to securities or related derivatives. As a result of these actions, Scotiabank may receive remuneration. All Scotiabank products and services are subject to the terms of applicable agreements and local regulations. Officers, directors and employees of Scotiabank and its affiliates may serve as directors of corporations.

Any securities discussed in this report may not be suitable for all investors. Scotiabank recommends that investors independently evaluate any issuer and security discussed in this report, and consult with any advisors they deem necessary prior to making any investment.

This report and all information, opinions and conclusions contained in it are protected by copyright. This information may not be reproduced without the prior express written consent of Scotiabank.

™ Trademark of The Bank of Nova Scotia. Used under license, where applicable.

Scotiabank, together with “Global Banking and Markets”, is a marketing name for the global corporate and investment banking and capital markets businesses of The Bank of Nova Scotia and certain of its affiliates in the countries where they operate, including: Scotiabank Europe plc; Scotiabank (Ireland) Designated Activity Company; Scotiabank Inverlat S.A., Institución de Banca Múltiple, Grupo Financiero Scotiabank Inverlat, Scotia Inverlat Casa de Bolsa, S.A. de C.V., Grupo Financiero Scotiabank Inverlat, Scotia Inverlat Derivados S.A. de C.V. – all members of the Scotiabank group and authorized users of the Scotiabank mark. The Bank of Nova Scotia is incorporated in Canada with limited liability and is authorised and regulated by the Office of the Superintendent of Financial Institutions Canada. The Bank of Nova Scotia is authorized by the UK Prudential Regulation Authority and is subject to regulation by the UK Financial Conduct Authority and limited regulation by the UK Prudential Regulation Authority. Details about the extent of The Bank of Nova Scotia's regulation by the UK Prudential Regulation Authority are available from us on request. Scotiabank Europe plc is authorized by the UK Prudential Regulation Authority and regulated by the UK Financial Conduct Authority and the UK Prudential Regulation Authority.

Scotiabank Inverlat, S.A., Scotia Inverlat Casa de Bolsa, S.A. de C.V., Grupo Financiero Scotiabank Inverlat, and Scotia Inverlat Derivados, S.A. de C.V., are each authorized and regulated by the Mexican financial authorities.

Not all products and services are offered in all jurisdictions. Services described are available in jurisdictions where permitted by law.