

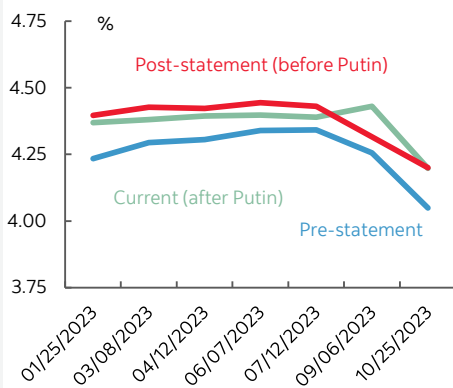
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Chart 1

Bank of Canada OIS Implied Policy Rate



Sources: Scotiabank Economics, Bloomberg.

Bank of Canada Hawkishly Surprises Markets

- BoC hiked 50bps, more than priced, matching our soft conviction
- Forward guidance struck the right balance toward next steps...
- ...by leaving the door a little less open to another rate hike
- The next move depends highly upon data and event risk over the next seven weeks
- What changed in the statement and what's next for communications.

The BoC hiked by 50bps and left the door a little less open to continuing to raise its policy rate. On balance the statement was more hawkish than markets anticipated. It was in line with Scotia's expectations for 50bps and forward guidance, albeit we had warned that conviction was pretty soft around multiple scenarios.

Markets responded by raising the 2-year Government of Canada bond yield by 10 bps, lifting the 5 year yield by 8 bps, and raising terminal rate pricing by about 9bps and are pricing part of another 25bps hike into January and subsequently before starting to price the chance at a rate cut by the end of next year. The Canadian dollar also appreciated by a half penny at first but has since drawn even post-statement partly due to safe haven seeking into the USD on Putin's repeated warnings about nukes that hit headlines shortly after the BoC statement arrived. Chart 1 shows the meeting-by-meeting market pricing of future moves pre-statement, post-statement but pre-Putin and post-statement and post-Putin.

What they Said

Key in the attached statement comparison is the final paragraph. They are now "considering" whether to continue hiking versus the prior determination.

That's actually not as big of a change as some are making it out to be. Here's what they said in October:

"The Governing Council expects that the policy interest rate will need to rise further. Future rate increases will be influenced by our assessments of how tighter monetary policy is working to slow demand, how supply challenges are resolving, and how inflation and inflation expectations are responding."

And here is what they now say:

"Looking ahead, Governing Council will be considering whether the policy interest rate needs to rise further to bring supply and demand back into balance and return inflation to target. Governing Council continues to assess how tighter monetary policy is working to slow demand, how supply challenges are resolving, and how inflation and inflation expectations are responding."

And so you could argue that they took the first step to sounding more cautious with their forward guidance at the October meeting and built upon that today. Instead of "will need to rise further" alongside conditional language around future hikes after this one, they are now "considering" whether to hike again after today's 50bps which sounds a little less decisive.

It's not, in my opinion, a quantum shift. That language closes the door to further hikes a touch more than what they had already intimated in the October statement but nevertheless leaves it open.

Other notable changes in the statement included the following points with assessments of each points hawkish/dovish slant:

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- They acknowledged that global growth “is proving more resilient than was expected” in the October MPR. That’s hawkish in isolation.
- They signalled unease toward the risks facing supply chains by noting that “further progress could be disrupted by geopolitical events.” I swear Putin read that when he warned about nukes 10 minutes after the statement dropped. This is also mildly more hawkish from the standpoint of potentially interrupting disinflationary progress.
- The BoC flagged that Q3 Canadian growth was stronger than they forecast. About double to be exact. That’s also hawkish acknowledgement that the economy pushed further into excess demand conditions, but it’s just a statement of already known fact.
- Netting through the growth drivers, they reaffirmed “the Bank’s outlook that growth will essentially stall through the end of this year and the first half of next year.” That’s the not-recession-because-we-can’t-say-it nod. Dovish, but not incrementally so.
- The main dovish nod was the reference to how “Three-month rates of change in core inflation have come down, an early indicator that price pressures may be losing momentum.” That’s a little stronger than the prior statement’s comment on the 3-month trend. The caution here is whether that’s just a transitory development in the context of still strong underlying cyclical and structural drivers.
- Nevertheless, they took that back in part by noting that “inflation is still too high and short-term inflation expectations remain elevated” while repeating worry about expectations the longer inflation remains above target.

PRESERVING OPTIONALITY

Overall I think they did the right thing here given what we know to this point. Slamming the door shut by declaring an absolute end to the hike cycle would have been too aggressive in my view and as the policy rate pushes further into restrictive territory they should be transitioning toward something that is more sensitive to new information. My conviction toward the BoC’s stance was high from when I was writing notes in late 2020 and early 2021 saying they’d hike by early 2022 while they underestimated inflation risk, but that conviction is much weaker the further we push into restrictive territory for the policy rate.

On that note, the forward guidance sounds more conditional which increases optionality into the January 25th meeting which in today’s world may as well be a decade from now. By then we will have two more CPI prints to inform whether they’ve been head faked of late or something more durable is building, plus another jobs report alongside greater clarity around how high the Fed is willing to go.

HAWKISH OR DOVISH?

So do you call it dovish, hawkish, or somewhere in between? Hiking more than was priced and leaving the door open without a clearer signal that “we’re done!” is pretty clearly more hawkish than markets expected. The market reaction is likely sensible to this point. Now we have a job to do in tracking developments on the rather long road until the next full forecast meeting.

LEFT UNANSWERED

Not once was there a reference to wage growth and wage-price pressures. Wage growth is strong in Canada and productivity has tumbled throughout the pandemic. Governor Macklem has delivered a speech that boldly declared wage growth was peaking now which is highly debatable and he also failed to even mention moribund labour productivity. Is the reason such references are absent from the statement a sign he is wavering after the last jobs report? Why not statement-codify such an expectation if he still so strongly believes this?

Also, what does the Governor now think of CAD? He sparked interest with his comments earlier this Fall that suggested greater unease toward the Canadian dollar’s depreciation. Then he went quiet on the topic as CAD appreciated from mid-October to early November. Now that it has resumed trend weakening notwithstanding today’s modest move is he more or less concerned about CAD and layering on lagging price pass through effects into next year? Normally the BoC would look through this, but we don’t have normal inflation or normal expectations and so what the Governor thinks about another modest potential upside catalyst to inflation may be useful to know.

NEXT UP

Deputy Governor Kozicki delivers the customary day after BoC speech tomorrow. The embargo lifts at 12:30pmET and there will be a press conference at 2pmET.

Governor Macklem then speaks next week on Monday to deliver the Governor’s usual pre-holiday speech and press conference ([here](#)). Last year’s was a hawkish pivot (and then he whiffed in January, but anyway...). I think his speech is likely to follow a similar tone to the statement but he may add to our understanding of the probability of approaching an end to the rate hike cycle.

December 7, 2022

RELEASE DATE: December 7, 2022

The Bank of Canada today increased its target for the overnight rate to 4¼%, with the Bank Rate at 4½% and the deposit rate at 4¼%. The Bank is also continuing its policy of quantitative tightening.

Inflation around the world remains high and broadly based. **Global economic growth is slowing, although it is proving more resilient than was expected at the time of the October Monetary Policy Report (MPR).** In the United States, the economy is weakening but consumption continues to be solid and the labour market remains overheated. The gradual easing of global supply bottlenecks continues, although further progress could be disrupted by geopolitical events.

In Canada, GDP growth in the third quarter was stronger than expected, and the economy continued to operate in excess demand. Canada's labour market remains tight, with unemployment near historic lows. While commodity exports have been strong, **there is growing evidence that tighter monetary policy is restraining domestic demand:** consumption moderated in the third quarter, and housing market activity continues to decline. **Overall, the data since the October MPR support the Bank's outlook that growth will essentially stall** through the end of this year and the first half of next year.

CPI inflation remained at 6.9% in October, with many of the goods and services Canadians regularly buy showing large price increases. Measures of core inflation remain around 5%. **Three-month rates of change in core inflation have come down, an early indicator that price pressures may be losing momentum. However, inflation is still too high and short-term inflation expectations remain elevated. The longer that consumers and businesses expect inflation to be above the target, the greater the risk that elevated inflation becomes entrenched.**

Looking ahead, **Governing Council will be considering whether the policy interest rate needs to rise further** to bring supply and demand back into balance and return inflation to target. Governing Council continues to assess how tighter monetary policy is working to slow demand, how supply challenges are resolving, and how inflation and inflation expectations are responding. Quantitative tightening is complementing increases in the policy rate. We are resolute in our commitment to achieving the 2% inflation target and restoring price stability for Canadians.

RELEASE DATE: October 26, 2022

The Bank of Canada today increased its target for the overnight rate to 3¾%, with the Bank Rate at 4% and the deposit rate at 3¾%. The Bank is also continuing its policy of quantitative tightening.

Inflation around the world remains high and broadly based. This reflects the strength of the global recovery from the pandemic, a series of global supply disruptions, and elevated commodity prices, particularly for energy, which have been pushed up by Russia's attack on Ukraine. The strength of the US dollar is adding to inflationary pressures in many countries. Tighter monetary policies aimed at controlling inflation are weighing on economic activity around the world. As economies slow and supply disruptions ease, global inflation is expected to come down.

In the United States, labour markets remain very tight even as restrictive financial conditions are slowing economic activity. The Bank projects no growth in the US economy through most of next year. In the euro area, the economy is forecast to contract in the quarters ahead, largely due to acute energy shortages. China's economy appears to have picked up after the recent round of pandemic lockdowns, although ongoing challenges related to its property market will continue to weigh on growth. Overall, the Bank projects that global growth will slow from 3% in 2022 to about 1½% in 2023, and then pick back up to roughly 2½% in 2024. This is a slower pace of growth than was projected in the Bank's July Monetary Policy Report (MPR).

In Canada, the economy continues to operate in excess demand and labour markets remain tight. The demand for goods and services is still running ahead of the economy's ability to supply them, putting upward pressure on domestic inflation. Businesses continue to report widespread labour shortages and, with the full reopening of the economy, strong demand has led to a sharp rise in the price of services.

The effects of recent policy rate increases by the Bank are becoming evident in interest-sensitive areas of the economy: housing activity has retreated sharply, and spending by households and businesses is softening. Also, the slowdown in international demand is beginning to weigh on exports. Economic growth is expected to stall through the end of this year and the first half of next year as the effects of higher interest rates spread through the economy. The Bank projects GDP growth will slow from 3¼% this year to just under 1% next year and 2% in 2024.

In the last three months, CPI inflation has declined from 8.1% to 6.9%, primarily due to a fall in gasoline prices. However, price pressures remain broadly based, with two-thirds of CPI components increasing more than 5% over the past year. The Bank's preferred measures of core inflation are not yet showing meaningful evidence that underlying price pressures are easing. Near-term inflation expectations remain high, increasing the risk that elevated inflation becomes entrenched.

The Bank expects CPI inflation to ease as higher interest rates help rebalance demand and supply, price pressures from global supply disruptions fade, and the past effects of higher commodity prices dissipate. CPI inflation is projected to move down to about 3% by the end of 2023, and then return to the 2% target by the end of 2024.

Given elevated inflation and inflation expectations, as well as ongoing demand pressures in the economy, the **Governing Council expects that the policy interest rate will need to rise further. Future rate increases will be influenced by our assessments of how tighter monetary policy is working to slow demand, how supply challenges are resolving, and how inflation and inflation expectations are responding.** Quantitative tightening is complementing increases in the policy rate. We are resolute in our commitment to restore price stability for Canadians and will continue to take action as required to achieve the 2% inflation target.

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