**January 26, 2022**

# BoC holds steady but tees up rate hikes

- Overnight rate held at 0.25% as expected but in a close call.
- BoC drops forward guidance with economic slack now absorbed.
- Hikes imminent as "Governing Council expects interest rates will need to increase."

The BoC opted against raising its benchmark policy rate today in what was likely a close call. Markets were looking for a hike but consensus tilted toward a steady rate decision in line with our call. Recent economic data—particularly robust jobs numbers and a Business Outlook Survey littered with references to capacity and price pressures—make a strong case that a near-zero overnight rate is no longer needed. And upward revisions to the BoC's inflation forecasts (now expected to average 4.2% in 2022) argue against too much patience in getting a tightening cycle underway. But the BoC decided to use today's meeting to tee up forthcoming rate increases, noting that its forward guidance condition has been met (i.e. economic slack has been absorbed) and clearly indicating upcoming meetings are 'live' for rate hikes. The fact that its next meeting is a short five weeks away may have contributed to the BoC's patience. While it said Omicron is likely to be less economically damaging than past waves (Q1 GDP seen slowing to 2%) the bank should become more confident of that in the coming weeks. Holding steady today also allows for a more graceful exit from its forward guidance than if the BoC hiked in January after reiterating its "middle quarters of 2022" guidance in December.

Our call has been for the BoC to begin raising rates in April, though three months looks like a long time when the economy is already at full capacity and inflation is expected to remain elevated over the first half of the year. The BoC has made it clear that rate hikes are coming and likely wants to send a message to Canadians—sooner rather than later—that it is acting to control inflation. Our forecast has been for three rate hikes this year though we see upside risk to that call if the BoC does get an earlier start. That said, we continue to think the market is over-priced for more than five rate increase in 2022 and the BoC's patience today increases our confidence that the central bank won't be overly aggressive in its pace of tightening. The BoC also indicated that, once it begins to raise rates, it will consider exiting the reinvestment phase of QE and begin shrinking its balance sheet. We think such a move could come in the first half of this year, though we'd emphasize that most tightening in financial conditions will come from the BoC raising its policy rate, not shrinking its balance sheet.

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