RBC Economics

Daily Economic Update

June 1, 2022

BoC hikes another 50 bps and isn't done yet

- Second consecutive 50 bp hike lifts overnight rate to 1.5%
- Hawkish statement reinforces our call for another 50 bp hike in July
- Hard to see the BoC pausing anytime soon—we forecast a 2.5% policy rate by October

Today's half point hike—the second in a row—was unanimously expected as the BoC continues to march monetary policy toward a more neutral stance. Last month Deputy Governor Gravelle described the bank's 1% overnight rate as "too stimulative" and the same could be said of today's 1.5%. Indeed, the policy statement noted that with the economy in excess demand and inflation well above target and still yet to peak, "interest rates will need to rise further." It finished by saying the bank is "prepared to act more forcefully if needed"—that's not new language for the BoC but it's new to the policy statement. This hawkish tone reinforces our call for yet another 50 bp hike in July, which would lift the overnight rate to the lower end of the BoC's 2-3% neutral estimate. At that point we think these decisions will become less automatic. But this doesn't sound like a central bank that is planning to pause at 2%, and we continue to look for additional 25 bp hikes in September and October resulting in a terminal rate of 2.5%.

Inflation was front and centre in today's statement. The latest CPI report, after all, came in a full percentage point above the BoC's Q2 forecast and it acknowledged inflation will likely rise further in the near term before beginning to ease. The statement noted global trends of higher food and energy prices (largely outside of the bank's control) but said inflation continues to broaden with its three core measures all above the 1-3% target range for inflation. Notably, the bank said there is a growing risk that elevated inflation becomes entrenched—a scenario that would call for more aggressive tightening than we and the market are assuming. Again, in this environment it's hard to see the bank pausing its tightening cycle at the low end of neutral.

The bank sounded upbeat on current economic conditions. Yesterday's Q1 GDP report was in line with its expectations and we agree that growth looks set to pick up in the current quarter. The statement noted slowing global growth due to a number of shocks (Russia-Ukraine, China's lockdowns, ongoing supply disruptions) which are also pushing inflation higher. That said, it still expects Canada's exports to strengthen. Housing is already beginning to feel the effects of rate hikes but the BoC didn't dwell on the early signs of a slowdown, noting activity is coming off "exceptionally high levels." It also noted but didn't make much of tightening global financial conditions and market volatility. All told, the bank passed on a number of opportunities to inject more caution or dovishness into today's statement, focusing instead on the many arguments for further tightening. Yields have unsurprisingly moved higher after today's announcement.

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