

September 7, 2022

BoC opts for another oversized hike and firm tightening bias

- BoC goes big again with a 75 bp hike in September
- 3.25% overnight rate puts monetary policy in 'restrictive' territory
- Statement flags further tightening to come, but pace likely to slow

The BoC continued on its steepest rate-hiking path in decades, following up July's 100 bp increase with a slightly smaller (but still oversized) 75 bp hike today. The move was in line with expectations and lifts the overnight rate to 3.25%, slightly above the 2-3% range the BoC considers neutral. With monetary policy now in 'restrictive' territory debate will heat up over just how much further rates need to rise, if at all. The BoC pushed back against calls for a pause after today's hike, saying "Governing Council still judges that the policy interest rate will need to rise further." That said, it hinted that the pace of rate hikes will slow going forward as it assess the impact of tightening thus far. Our forecast assumes one more 25 bp increase in October, though today's meeting suggests upside risk to our call for the overnight rate to peak at 3.50%.

Beyond a very clear tightening bias, today's statement leaned slightly hawkish with the BoC taking little solace in a gasoline price-driven decline in headline inflation in July. It noted core measures continued to move higher and we think that could be the case again in August. While some of the external drivers of inflation (oil and other commodity prices, shipping costs, supply chain bottlenecks) are easing the BoC will want to see core measures moving lower before it pauses rate hikes. Governing Council will also be watching for improvement in the inflation expectations components of its quarterly business and consumer surveys. Worrying trends in the July BOS and CSCE contributed to the BoC's surprise 100 bp hike later that month, and today's statement noted short-term inflation expectations remain high.

Finally, while Q2 GDP came in softer than expected, the BoC emphasized strong domestic demand and a housing market that is pulling back "as anticipated." But the economy carried little momentum into Q3, and the bank reiterated its expectation that growth will moderate in the second half of the year—a slowdown that's needed to bring demand more in line with supply. The BoC is hoping to pull that off without tipping the economy into recession, though getting inflation under control remains its top priority. We continue to expect a mild recession in 2023.

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