

ESSENTIALS OF THE MONETARY POLICY

Bank of Canada (BoC)

“Shock and awe” of a supersized rate hike plus QT

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ACCORDING TO THE BOC

- ▶ The BoC announced today an increase in the target overnight rate from 0.50% to 1.00% - the first time we've seen an interest rate hike of this size since May 2000.
- ▶ The BoC is also ending reinvestment and will begin quantitative tightening (QT), effective April 25. Maturing Government of Canada bonds on the Bank's balance sheet will no longer be replaced and, as a result, the size of the balance sheet will decline over time.
- ▶ The BoC believes this will help to rein in CPI inflation, which it now expects to average almost 6% in the first half of 2022 and remain well above the control range throughout this year. It is then expected to ease to about 2½% in the second half of 2023 and return to the 2% target in 2024. This is a meaningfully higher inflation outlook that was published in the January 2022 MPR.
- ▶ The Bank forecasts that Canada's economy will grow by 4¼% this year before slowing to 3¼% in 2023 and 2¼% in 2024. Robust business investment, labour productivity growth and higher immigration will be offset by more moderate domestic demand due to higher interest rates.
- ▶ Upward revisions to the real GDP outlook were greater than the increase in the Bank's estimate of potential GDP, leading the estimate of the output gap into positive territory in Q1 2022 (albeit partly the result of temporary factors holding back the supply side of the economy). At the same time, the BoC also modestly revised up the mid range of its estimate of the neutral interest rate – the rate consistent with both output remaining sustainably at its potential and inflation remaining at target – to 2.5% as a result of those temporary factors reversing

COMMENTS

There weren't a lot of surprises in today's interest rate announcement and Monetary Policy Report (MPR). Markets had almost unanimously priced in a 50-basis point rate hike and the start of QT. Indeed, BoC communications were clear that Canadians should expect a “forceful” response to exceptionally high inflation. Higher real GDP growth and inflation forecasts for 2022 were also anticipated, given the year-to-date data, commodity prices skyrocketing as a result of Russia's attack on Ukraine, and supply chain disruptions that have yet to meaningfully ease.

Where we were more surprised was on the upward revisions to potential GDP growth and the neutral interest rate. Much is predicated on the increased investment intentions of firms currently struggling to fill job vacancies and the government's plan to bring in over 1 million new immigrants in the next three years. It's a big bet, but one which the Bank views as potentially allowing it to have more room for future hikes.

IMPLICATIONS

During the press conference, Governor Macklem chose to set Canadians up for another round of aggressive action in June by suggesting that the Bank could continue to raise rates “forcefully”, if needed. That opens the door to another 50bp hike at the next announcement. Still, we see the overnight policy rate ending the year around 2%. We see scope for some further tightening in 2023, but don't believe the BoC will match the Fed in taking rates above 3%, given the greater weight of real estate in the Canadian economy.

Schedule 2022 of Central Bank Meetings

Date	Central banks	Decision	Rate
January			
13	Bank of Korea	+25 b.p.	1.25
17	Bank of Japan	s.q.	-0.10
20	Bank of Norway	s.q.	0.50
26	Bank of Canada*	s.q.	0.25
26	Federal Reserve	s.q.	0.25
31	Reserve Bank of Australia	s.q.	0.10
February			
2	Bank of Brazil	+150 b.p.	10.75
3	European Central Bank	s.q.	0.00
3	Bank of England	+25 b.p.	0.50
10	Bank of Sweden	s.q.	0.00
10	Bank of Mexico	+50 b.p.	6.00
22	Reserve Bank of New Zealand	+25 b.p.	1.00
23	Bank of Korea	s.q.	1.25
28	Reserve Bank of Australia	s.q.	0.10
March			
2	Bank of Canada	+25 b.p.	0.50
10	European Central Bank	s.q.	0.00
16	Bank of Brazil	+100 b.p.	11.75
16	Federal Reserve	+25 b.p.	0.50
17	Bank of England	+25 b.p.	0.75
17	Bank of Japan	s.q.	-0.10
24	Bank of Norway	+25 b.p.	0.75
24	Bank of Mexico	+50 b.p.	6.50
24	Swiss National Bank	s.q.	-0.75
April			
5	Reserve Bank of Australia	s.q.	0.10
12	Reserve Bank of New Zealand	+25 b.p.	1.25
13	Bank of Canada*	+50 b.p.	1.00
13	Bank of Korea		
14	European Central Bank		
27	Bank of Japan		
28	Bank of Sweden		
May			
3	Reserve Bank of Australia		
4	Bank of Brazil		
4	Federal Reserve		
5	Bank of England		
5	Bank of Norway		
12	Bank of Mexico		
24	Reserve Bank of New Zealand		
25	Bank of Korea		
June			
1	Bank of Canada		
7	Reserve Bank of Australia		
9	European Central Bank		
15	Bank of Brazil		
15	Federal Reserve		
16	Bank of England		
16	Bank of Japan		
16	Swiss National Bank		
23	Bank of Norway		
23	Bank of Mexico		
30	Bank of Sweden		

Date	Central banks	Decision	Rate
July			
5	Reserve Bank of Australia		
12	Reserve Bank of New Zealand		
13	Bank of Korea		
13	Bank of Canada*		
20	Bank of Japan		
21	European Central Bank		
27	Federal Reserve		
August			
2	Reserve Bank of Australia		
3	Bank of Brazil		
4	Bank of England		
11	Bank of Mexico		
16	Reserve Bank of New Zealand		
18	Bank of Norway		
24	Bank of Korea		
September			
6	Reserve Bank of Australia		
7	Bank of Canada		
8	European Central Bank		
15	Bank of England		
20	Bank of Sweden		
21	Bank of Brazil		
21	Bank of Japan		
21	Federal Reserve		
22	Bank of Norway		
22	Swiss National Bank		
29	Bank of Mexico		
October			
3	Reserve Bank of Australia		
4	Reserve Bank of New Zealand		
13	Bank of Korea		
26	Bank of Brazil		
26	Bank of Canada*		
27	European Central Bank		
27	Bank of Japan		
31	Reserve Bank of Australia		
November			
2	Federal Reserve		
3	Bank of England		
3	Bank of Norway		
10	Bank of Mexico		
22	Reserve Bank of New Zealand		
23	Bank of Korea		
24	Bank of Sweden		
December			
5	Reserve Bank of Australia		
7	Bank of Brazil		
7	Bank of Canada		
14	Federal Reserve		
15	European Central Bank		
15	Bank of England		
15	Bank of Norway		
15	Bank of Mexico		
15	Swiss National Bank		
19	Bank of Japan		

NOTE: Certain banks may decide to change rates in-between the scheduled meetings. The abbreviations s.q. and b.p. correspond to status quo and basis points respectively. * Monetary Policy Report published.