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International Commentary — June 7, 2023

Bank of Canada Resumes Rate Hikes

Summary

Bank of Canada policymakers surprised at today's monetary policy announcement, lifting the policy interest rate 25 bps to 4.75% at today's meeting. The statement contained some hawkish signals, particularly around policymaker concerns that CPI inflation could get stuck above the 2% target and that the economy remain in excess demand. As a result, we have adjusted our Bank of Canada forecast and now believe another 25 bps rate hike to 5.00% will be delivered in July. In addition, we believe monetary easing will start later, and believe Bank of Canada policymakers will now look to initiate rate cuts starting in Q2-2024.

Economist(s)

Nick Bennenbroek
International Economist | Wells Fargo Economics
Nicholas.Bennenbroek@wellsfargo.com | 212-214-5636

Bank of Canada Resumes Rate Hikes

The Bank of Canada raised is policy interest rate at today's announcement by 25 bps to 4.75%. The rate hike was a hawkish surprise for the majority of economists (ourselves included) that had expected the BoC to hold steady at today's meeting. Indeed, following the BoC's pause in January we have for some time expected 4.50% to be the policy rate peak for the current cycle, while acknowledging there remained some risk of further tightening. Today's interest rate increase was also something of a surprise for market participants, who saw around a 40% chance of a rate hike ahead of today's meeting.

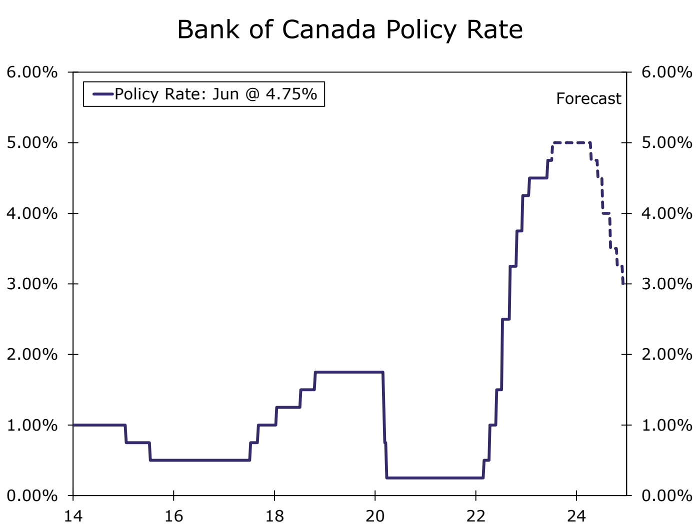
In addition to the 25 bps rate hike, there were some hawkish elements in the Bank of Canada's accompanying statement. The BoC noted the strong Q1 GDP outcome, adding that consumption growth was surprisingly strong and broad-based, while also saying that housing activity has picked up and the labor market remains tight. Overall, the BoC said excess demand in the economy looks to be more persistent than anticipated. For us, there were two notably hawkish passages in the Bank of Canada's announcement:

- "...with three-month measures of core inflation running in the 3½-4% range for several months and excess demand persisting, concerns have increased that CPI inflation could get stuck materially above the 2% target."

and

- "Based on the accumulation of evidence, Governing Council decided to increase the policy interest rate, reflecting our view that monetary policy was not sufficiently restrictive to bring supply and demand back into balance and return inflation sustainably to the 2% target."

Looking ahead, although the central bank did not offer substantive forward guidance regarding its next policy moves, we believe today's announcement is consistent with at least another 25 bps rate increase, and lean towards that rate hike being delivered as soon as the July 12 meeting. Concerns about inflation getting stuck materially above the 2% target appeared to be the main driver for the Bank of Canada coming off the sidelines. Between now and the July policy announcement, Canada releases employment reports for May and June, as well as the CPI report for May. **Unless job growth slows sharply or inflation surprises significantly to the downside, which we do not view as likely, the same concerns that prompted today's interest rate increase will also likely prompt another 25 bps rate hike in July to 5.00%.** Moreover, we expect that concerns about inflation getting stuck above target will also discourage the Bank of Canada from easing monetary policy prematurely. Combined with our outlook for U.S. economic resilience to persist for longer and Federal Reserve easing to begin later, **we now do not expect the Bank of Canada to begin lowering interest rates until Q2-2024. As Canadian economic growth moderates and inflation moves closer to target, we see 200 bps of rate cuts through the rest of 2024, with the Bank of Canada's policy rate ending next year at 3.00%.**



Source: Bloomberg Finance L.P. and Wells Fargo Economics

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Economics Group

Jay H. Bryson, Ph.D.	Chief Economist	704-410-3274	Jay.Bryson@wellsfargo.com
Sam Bullard	Senior Economist	704-410-3280	Sam.Bullard@wellsfargo.com
Nick Bennenbroek	International Economist	212-214-5636	Nicholas.Bennenbroek@wellsfargo.com
Tim Quinlan	Senior Economist	704-410-3283	Tim.Quinlan@wellsfargo.com
Sarah House	Senior Economist	704-410-3282	Sarah.House@wellsfargo.com
Azhar Iqbal	Econometrician	212-214-2029	Azhar.Iqbal@wellsfargo.com
Charlie Dougherty	Senior Economist	212-214-8984	Charles.Dougherty@wellsfargo.com
Michael Pugliese	Senior Economist	212-214-5058	Michael.D.Pugliese@wellsfargo.com
Brendan McKenna	International Economist	212-214-5637	Brendan.Mckenna@wellsfargo.com
Jackie Benson	Economist	704-410-4468	Jackie.Benson@wellsfargo.com
Shannon Seery	Economist	332-204-0693	Shannon.Seery@wellsfargo.com
Nicole Cervi	Economic Analyst	704-410-3059	Nicole.Cervi@wellsfargo.com
Jessica Guo	Economic Analyst	212-214-1063	Jessica.Guo@wellsfargo.com
Karl Vesely	Economic Analyst	704-410-2911	Karl.Vesely@wellsfargo.com
Patrick Barley	Economic Analyst	704-410-1232	Patrick.Barley@wellsfargo.com
Jeremiah Kohl	Economic Analyst	704-410-1437	Jeremiah.J.Kohl@wellsfargo.com
Coren Burton	Administrative Assistant	704-410-6010	Coren.Burton@wellsfargo.com

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