BOC PREVIEW: BoC rate decision due Wednesday 1st June 2022 at 15:00BST/10:00 EDT

- BoC widely expected to hike rates by 50bps to 1.50%.
- Commentary on the rate outlook will be key and how "forceful" they will be.
- No press conference, but Schembri will deliver the Economic Progress Report on Thursday.

SUMMARY: The decision will be a statement only affair and there is no press conference with Governor Macklem after, although BoC Deputy governor Schembri will be speaking the following day at 16:00BST/11:00EDT for the Economic Progress report. The BoC is expected to hike rates by 50bps to 1.50%. Attention in the statement will be to any clues on forward guidance to gauge the size of future rate hikes, alongside any commentary about going above neutral (seen between 2-3%) or moving in a "forceful" way to tackle inflation after the hot April CPI prints and recent commentary from Governor Macklem. On QT, the Bank will likely reiterate that maturing bonds will continue to roll off the balance sheet. It will also likely acknowledge above-target inflation, and the hot housing market, but reiterate it expects it to moderate, while also stressing the ongoing economic uncertainty.

RATE OUTLOOK: The Bank of Canada is widely expected to hike rates by 50bps once again in June, taking its key rate to 1.50%. A survey by Reuters found that all 30 economists expect this to be the case, in line with market pricing. The poll median showed rates at 2.25% in Q3 and 2.50% in Q4 and is expected to hike to 2.75% in Q1 23, before staying put until the end of 2023. 25 of those surveyed expect rates to rise to 2.50% or more in Q4 22, where six expect rates at 2.75% and another six see the BoC Overnight Target Rate at 3.00%, but four expect rates at 2.25%, and one sees it at 1.75%. Currently, markets are pricing in rates at 2.75% by year-end. A poll a month earlier, saw analysts expect a 25bp hike from the BoC in June, so expectations have leant hawkish in wake of hot CPI prints and hawkish commentary. Canadian bank RBC wrote that “the BoC is laser-focussed on taming inflation, but once the overnight rate reaches a more neutral level, it will be conscious of the potential trade-off between returning inflation expediently to target and prolonging the economic cycle”; RBC does not expect the BoC to take policy into restrictive territory (the neutral rate is estimated to be between 2-3%) unless inflation dynamics were compelling it to do so, and RBC warns that if it did, it would “amplify recession risk.” On the flip side, however, ING expects the BoC to hike above neutral to 3.5% in early 2023, but the bank will not be surprised to see the BoC mulling reversing course in late 2023 as the harder and faster it tries to tame inflation, the greater chance of an adverse reaction to the economy. Note, a Reuters poll of fourteen economists revealed a split on views on whether the current tightening would lead to an economic recession.

RECENT DATA: Canada's CPI was hot, rising above expectations for both Y/Y and M/M rates on the core metrics and headline, while the average of the BoC measures rose to 4.23% from 3.77%, moving further away from the Central Bank's 2% target. Employment continues to be strong and is outperforming the US labour market, although there was a slight cooling in April. Q1 GDP disappointed expectations, slowing to 3.1%, although the April MPR noted economic growth is expected to pick up to about 6% in Q2. However, any signs of growth cooldowns will be key as it could steer the BoC away from "forceful" tightening and may limit how far they go above neutral, particularly if inflation starts to cool. However, it is clear that inflation is the top priority, especially with inflation above the top end of the target range, and the Bank's primary focus is to return this to target.

RECENT COMMENTARY: Governor Macklem said another 50bps in June is to be expected and that he will not rule out hikes of more than 50bps, although it would be very unusual for this to occur. Macklem stated the Bank is committed to using interest rates to return inflation back to target and will do so forcefully if required, adding the Bank may have to increase rates above neutral to "a bit above 2 or 3%". Meanwhile, Senior Deputy Governor Rogers noted they cannot let demand get too far ahead of supply for the risk of adding further to inflation, calling for rates to move higher, but added they are not on autopilot and gave no mention of the word "forcefully", unlike Governor Macklem. Deputy Governor Gravelle noted the BoC will likely increase its near-term inflation forecasts further and the current policy rate of 1% is too stimulative when inflation is running above the top of the control range. Gravelle also noted it is possible the Bank may have to raise rates above neutral as parts of the economy might be less sensitive to hikes than in the past, while stronger housing activity is another reason for rates to rise above neutral. However, he did caveat that the BoC might pause hikes as rates re-enter the neutral range. Gravelle added the broadening of price pressures is a big concern, but they are not seeing a repeat of the 1970's style stagflation.

QT: In April, the BoC confirmed it is ending its reinvestment phase and started QT on April 25th. Little else was said other than Bank’s balance sheet will shrink over time, with roughly 40% of the Bank’s GoC bond holdings maturing within the next two years. Although a statement was released which reiterated it is not actively considering selling bonds as part of its QT process, as it will continue to implement monetary policy via a floor system that will remain in place even after QT is over. Therefore, any further details will be eyed in this meeting, if any, although as it is a statement only affair we may not see too much and analysts expect the Bank to reiterate that maturing bonds will continue to roll off the balance sheet.

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