Preview: BoC rate decision due 15:00BST/10:00EDT on Wednesday 7th September 2022

SUMMARY: The September meeting will be a statement-only affair with no accompanying MPR nor press conference, but BoC Deputy Governor Rogers will deliver the latest Economic Progress Report on September 8th at 16:40BST/11:40ET. The Bank of Canada is expected to hike rates by 75bps to 3.25% after the 100bp hike in July. Analyst forecasts range from 50bp to 100bp, albeit only one desk is expecting another 100bp tightening move from the BoC, and four look for a 50bp move with the vast majority expecting a 3/4 point hike. The market is currently pricing in a 95% implied probability of a 75bp hike, with a 5% probability of a 50bp move. The focus for the BoC remains firmly on hot inflation and housing market issues and the Bank is likely to continue to act to help address these concerns. Looking ahead, markets are pricing in a terminal BoC rate of around 3.8% by Spring-2023, while economists note that the risks are skewed towards a higher peak rate than they currently expect and therefore commentary in the statement around forward guidance will be key.

EXPECTATIONS: The Bank of Canada is expected to hike rates by 75bps to 3.25% after the 100bp hike in July, according to 20/25 analysts surveyed by Reuters. Four analysts expect a cooler 50bp move, taking the rate to 3.00%, while one bank, Credit Suisse, is expecting another 100bp move, although others do not rule out a 100bp hike after recent inflation data. With the overnight rate at 2.5%, it sits in the middle of the estimate of neutral and given recent rhetoric, the BoC has suggested rates will need to move "to the top end or slightly above" neutral - and their preferred way of doing so is through front loading hikes. A 75bp hike on Wednesday would lift the overnight rate to slightly above neutral. Seventeen economists surveyed noted risks are skewed to the upside toward a higher peak in the overnight rate than they currently expect, and that the BoC is more likely to hold rates for an extended period of time, rather than introduce rate cuts. Analysts at ING do not think the BoC will stop at 3.25% "given a desire to make positive restrictions to ensure inflation gets back to target". The desk expects a further 75bp of hikes by year-end." Note, markets are currently pricing in a terminal rate of ~3.8% with rates around 3.75% by December 2022.

INFLATION: Governor Macklem spoke in mid-August when he acknowledged that inflation has come down a little and may have peaked, but he said it still remains far too high and will likely remain too high for some time. The commentary on inflation signals more hikes are coming as inflation remains well above target, but with inflation potentially having peaked, it may reduce the need for such a large hike again after the 100bp move in July. The July CPI report was in line with expectations at 7.6%, cooling from 8.1%, and seeing a 0.1% M/M gain. However, the BoC core measures rose to 5.30% from a prior revised 5.23% - previously 5%. Analysts at Citi suggest this could easily justify another 100bp rate rise in their view, particularly with the BoC's message about front-loading rate hikes.

HOUSING: In a separate Reuters survey, participants were asked about house prices in Canada. The poll of 14 analysts saw on average that Canadian House prices would rise 10.3% this year, albeit still slower than the current 11% pace. Analysts also pointed out prices have declined 6% since the BoC tightening process began, but affordability is still years away. ING noted the housing market issue is a worry and it is also of concern that employment has declined for two consecutive quarters. Nonetheless, the desk sees the loss of jobs as a temporary phase and strength in domestic demand still suggests an upward trend in employment activity. Looking ahead, the survey found house prices are expected to fall 7.8% in 2023, while five respondents expect a double-digit decline.

REACTION: With markets almost completely pricing in a 75bp hike, ING points out there shouldn't be much reaction to the rate decision itself, it will instead depend on forward guidance. The desk suggests that "a Fed-style protest against any rate cut expectations for 2023 cannot be excluded and would have positive implications for CAD". ING also believes most of the benefits of BoC tightening for the CAD may take some time. It would likely rely on a stabilisation in global risk sentiment and some easing in USD strength, which "could start to happen towards the end of the year, and still, high energy prices do suggest that a move to 1.25 in early 2023 is a tangible possibility". Meanwhile, Citi's FX strategists believe CAD will be "idiosyncratically supported" by the rate decision and the sizable CAD short position held by leveraged investors enhances the risk of follow-through price-action, while also highlighting the CAD has notably weakened since July. Citi writes "The case for a tactical short in USDCAD would be bolstered exogenously by the possibility of flat to higher risk assets and oil prices – likely required, in our view, for a meaningful pullback into the 1.28-1.30 range. Otherwise, CAD strength may well prove to be short-lived".

PRIOR MEETING: The Bank of Canada surprised with a 100bps hike to 2.50% in July against expectations of a 75bps move. The statement stressed the need to bring inflation back to target and pledged to hike rates further, while the pace of future hikes will be guided by the BoC's assessment of the economy. It also removed language to act "forcefully" to combat high inflation (signalling the 100bps move was deemed forceful in itself, and will unlikely happen again based on the inflation estimates at the time of the meeting). Governor Macklem noted the reasoning behind the larger, "very unusual" hike was decided as the BoC want to front-load rate hikes. The Bank believes it provides a better opportunity for a softer landing and will mean it can avoid having even higher rates down the road, while quick rate hikes prevent inflation from becoming entrenched. However, analysts at RBC suggest a soft landing will be difficult to achieve and expect a "mild recession" next year. Macklem also stressed an economic slowdown is needed and there is lots of room to reduce job vacancies without materially impacting unemployment. The BoC rate is now in the middle of the neutral range estimate between 2-3% and Macklem once again signalled they are ready to move "quickly to the top end or slightly above" neutral. The latest MPR saw growth revised significantly lower for 2022 and 2023, but revised slightly higher for 2024, meanwhile inflation estimates were raised across 2022 to 2024 from its prior MPR in April.