Preview: BoC rate decision due Wednesday 7th December 2022 at 15:00 GMT / 10:00 EST

SUMMARY: The BoC rate decision will be a statement-only affair, although Deputy Governor Sharon Kozicki is speaking the following day. Analysts are split on the size of the expected rate hike, with 16/30 surveyed by Reuters expecting the Bank to hike by 50bps again taking its target for the overnight rate to 4.25%. However, the remaining 14 analysts see a smaller 25bp hike to 4.00%. Market pricing is leaning towards a 25bp move with circa 70% probability at the time of writing and just a 30% chance of a 50bp hike. Any language on the terminal rate or guidance will also be key with markets implying a peak rate of 4.30% by the middle of next year. If the BoC opts for a 50bp hike at this meeting, they could use it as an opportunity to bring the tightening cycle to a pause as they assess the impact on the economy ahead of the expected slowdown. Meanwhile, a 25bp hike would then likely suggest another 25bp hike is to be expected in the months thereafter, although expectations are quite varied, ranging from a final 25bp hike, a final 50bp hike, two 25bp hikes, and a 50bp hike followed by a final 25bp move, so any clarity from the BoC on the outlook for rates will be of utmost importance.

GUIDANCE: Currently, guidance in the BoC statement says the "Governing Council expects that the policy interest rate will need to rise further. Future rate increases will be influenced by our assessments of how tighter monetary policy is working to slow demand, how supply challenges are resolving, and how inflation and inflation expectations are responding." There will be attention on this line in the final paragraph to see whether the BoC officially signals an end of the tightening cycle or maintains it. The message from other central banks, including the Fed, has been that the risk of doing too little is greater than doing too much, and if guidance is maintained, it is something the BoC could refer to when explaining the decision. Analyst forecasts for the terminal rate are quite varied, as they generally expect the BoC to signal more rate hikes to come, although the ranges on the peak rate vary significantly. Forecasts range from a final 25bp hike in December to 4.00%, a final 50bp hike in December to 4.25%, two 25bp hikes (one in December, one in early 2023) to 4.25%, or a 50bp hike in December, followed by a final 25bp to 4.50% in 2023. Nonetheless, it shows we are approaching the peak, and any language about how long the BoC opts to stay at the terminal rate will also be key, although they will likely take a data-dependent approach.

25 OR 50?: Given that analysts are split between a 25 or 50bp hike from the BoC, it is worth highlighting that with rates already in restrictive territory, the ultimate level of the Bank rate is seen as more important than the incremental steps. Nonetheless, with split forecasts, TD Securities have put together the arguments for both increments. For 25bps, the BoC has tightened substantially already, while the ex-food and energy CPI is showing signs of deceleration. TD adds recent commentary from the BoC suggests a degree of apprehension around the pace of tightening, and the desk does not expect the government's fiscal stimulus to get in the way in 2023. Meanwhile, the arguments for a 50bp hike include core inflation remaining too high, less slack in the economy than previously estimated, wage pressures are yet to slow while global central bank trends are hawkish with the Fed, BoE, ECB and RBNZ all hiking by 75bp at their last meetings, and with forecasts looking for a slowdown to 50bps next time. However, it is worth noting the BoC led the tightening cycle in the first place, and some analysts believe they will be the first to exit, ahead of the Fed, which is widely expected to hike by 50bps next week.

ECONOMY: The housing sector is weak and ING points out that the structure of mortgages in Canada means that Canadians are more impacted by rising rates than US homeowners. The latest jobs report for November came in hotter than expected with a drop in the unemployment rate while full-time employment saw a 51k rise, after the 119k gain in October. Inflation remains broad-based and although there are signs of it slowing, it still remains at an elevated level. The BoC's own assessment of the economy in October said it still operates in excess demand and the labour market remains tight, however, it did acknowledge the impact of tightening so far, including a retreat in housing activity, as well as spending by households and businesses.

RECENT COMMENTARY: Governor Macklem towards the end of November suggested the BoC expects the policy rate to rise further, but how much more will depend on how policy is working to slow demand. Macklem added the rate tightening phase will draw to a close, but the BoC is not there yet. The Governor also said that the effects of higher rates will take time to spread through the economy and they expect growth will stall in the next few quarters before picking up again. He did not sound impressed with the progress on inflation, stating it remains high and broad-based which reflects large increases in the prices of both goods and services while they are yet to see a generalised decline in price pressures. The BoC also expects inflation to stay quite high for the remainder of 2022, but start to decline in 2023.

REACTION: With the market pricing in around 30bps of tightening, a 50bp hike would be perceived as hawkish and likely trigger a CAD rally, ING writes. The desk however says they expect the post-meeting impact on FX to be short-lived as external factors remain more important for the Looney. ING thinks USD/CAD could end the year around 1.37 as USD strengthening is partly offset by a potential recovery in oil prices. ING also highlights that the recent fragility in risk sentiment shows downside risks for all high-beta currencies are elevated, but the CAD is considerably less directly exposed to swings in Chinese sentiment when compared to other cyclical currencies.