Preview: Bank of Canada Rate Decision, MPR & Press Conference

- The Bank of Canada interest rate decision & MPR will be announced at 15:00GMT/10:00EST on Wednesday January 25th 2023, Press Conference 1-hour later.
- It is expected to hike by 25bps to mark the peak of its tightening cycle.
- Eyes on the MPR for inflation and growth forecasts, as well as the output gap estimate.

SUMMARY: The BoC is expected to hike rates by 25bps in what will likely be the end of the tightening cycle and take rates to 4.50%. There will be eyes on the statement to see if the Bank explicitly signals an end of the hiking cycle, but it is expected to keep forward guidance unchanged after altering it in the December confab for the BoC to consider further hikes based on the data. There will also be an accompanying MPR with attention to inflation and growth forecasts, as well as the output gap. Note, this meeting will also see the BoC offer minutes from the meeting for the first time, which will be released on February 8th, although analysts do not expect the minutes to reveal too much.

INTEREST RATES: At the last meeting, the central bank altered guidance to show the Governing Council will be "considering" whether the policy interest rate needs to rise further showing they are around peak territory. With inflation still well above target and a hot jobs market, the BoC is expected to slow the pace of hikes once again to 25bps, taking its key interest rate to 4.50% and also signal a pause in the hiking cycle, although the risks are skewed towards a higher peak. 26/29 analysts surveyed by Reuters expect a 25bp move, with the remaining three forecasting an unchanged rate. Looking ahead, the poll median is for rates to be left unchanged throughout 2023, although two analysts look for another hike to 4.75%, while 14/20 said risks to their forecasts were skewed towards a higher terminal rate. The poll also asked once the BoC reaches the terminal rate, is it more likely to hold throughout the year, or cut rates? 55% said hold, while 45% said cut. Money markets are implying a 73% probability of a 25bp hike and a 27% probability for rates to be left unchanged. Looking ahead, rates are expected to be just above 4% by year-end.

STATEMENT: With the rate hike expected to be the last, there will be eyes on guidance to see if they alter it from "considering" further hikes, although if they maintain the language, it could show they are keeping options open as they continue to assess economic data. Analysts at RBC Capital Markets expect similar language in this statement to the December meeting to make it clear "it could be the last hike, but not committing to it and leaving the data to determine the near-term rate path". TD Securities are in the same camp as RBC, "We do not expect significant changes, as the Governing Council has no incentive to limit its options going forward".

RECENT DATA: The BoC prefers to focus on the core inflation measures, the trim, median and common. The average of the BoC's inflation measures saw a marginal slowing in December, to 5.63% from the prior 5.76%, albeit remaining well above the BoC target. Headline inflation printed -0.1% M/M with the Y/Y at 6.3%, slowing from 6.8% previously. Meanwhile, core inflation rose 0.3% M/M and matching the pace in November, although the BoC Core measure declined 0.3% M/M in a welcome sign. The December jobs data was very hot, the unemployment rate dipped to 5.0% from 5.1% with full-time jobs soaring with strong part-time jobs for an overall gain of 104k, well above the expected 8k and prior 10k. Meanwhile, the Q4 Business Outlook Survey found 84% of firms expect inflation to remain above 3% for the next two years, picking up from Q3's 77%, while it also found that a recession is likely. Although, on the flip side the Canadian Survey of Consumer Expectations (CSCE) showed that consumers' expectations for inflation five years ahead are near survey-low levels. Together, these results suggest that both businesses and consumers believe that inflationary pressures will eventually fade.

MPR/MINUTES: Analysts at TD Securities suggest growth forecasts for 2022 will be left unchanged but could be revised higher for 2023, although TD believes the BoC forecasts are currently too optimistic. The desk also looks for 2023 inflation to be revised lower. Meanwhile, TD looks for a positive output gap of between 0-1% in Q4 22 (prev. 0.25-1.25%). Note, there will also be minutes from this meeting released on February 8th, although given the meeting includes an MPR and press conference, analysts do not expect the minutes to reveal too much fresh information.

REACTION: With markets looking for either an unchanged or 25bp decision, analysts at Scotiabank write that either way there is risk weighing on the CAD and perhaps driving the spot well through 1.35, if only temporarily. The desk also highlights that IMM data shows speculative positioning reaching a net short of 31k, for the biggest bearish bet on the Loonie since mid-2019. Scotia adds that USDCAD risk reversal pricing offers the lowest premium for USD calls since late 2021, indicating weakening demand for protection against USD gains. TD Securities write "the CAD may not receive much directional bias from this meeting as the curve may continue to be biased about looking at the other side of this interest rate cycle". However, the CAD may be sensitive to any potential dovish guidance should the central bank emphasize elements of the Business Outlook Survey.