



Bank of Canada Rate Announcement

April 13 2022

Bank of Canada pulls trigger on 50 basis point hike, begins quantitative tightening

They did it. The Bank of Canada pulled the trigger on a 50- basis point hike, lifting the policy rate to 1.00 per cent amidst strong inflation pressures and clearly signaling more hikes to come. This marked the first time since May 2000 that the Bank has produced an increase of this magnitude. While still exceptionally low, there is only one direction in the immediate rate future – up. Adding to this, the Bank commenced quantitative tightening effective April 23, allowing maturing bonds to run off over time.

Today's increase rate hike came as little surprise given recent bank communications and a backdrop of elevated inflation and firm economic data. The accompanying Monetary Policy Report (MPR) provided a deeper dive into the Bank's outlook.

The Bank highlighted the ongoing war in Ukraine which at its core a humanitarian crisis but is lifting inflation through increases in oil and other commodity prices and higher production cost. While there is some drag on economic output in Europe and emerging challenges in China, the U.S. economy continues to expand above potential and inflation is high. The Fed has clearly communicated its intentions to cool inflation through monetary policy.

The Bank remained upbeat on the Canadian economy and one that is moving into a period of "excess demand". This includes a stronger than projected Q1 at 3.0 per cent and accelerated Q2 to an annualized rate of 6.0 per cent. Removal of pandemic restrictions is a driver, while external demand and higher commodity prices have supported Canada's terms of trade support investment. Labour markets are also tightening with a number of key indicators surpassing pre-pandemic levels and wage growth also recovering. Importantly, the Bank's surveys point to a period of excess demand and operating above capacity with more firms challenged to meet unexpected demand and passing on costs to consumers. The output gap has fallen to a range of -0.25 per cent to +0.75 per cent from the previous estimate of -0.75 per cent to +0.25 per cent. Going forward interest rates look to slow housing, but immigration, wages and investment still support domestic demand, and also support capacity growth. The Canadian economic forecast was revised upward for 2022 to 4.2 per cent but revised lower to 3.2 per cent for 2023 according to the MPR.

Strong inflation is forecast to continue through Q2. The Bank's first quarter inflation estimate of 5.6 per cent (revised from 5.1 per cent in the previous MPR) is expected to accelerate to 5.8 per cent in the second quarter (with an early Q2 peak). Stronger inflation has broadened and become more widespread among products and services. From its statement "CPI inflation is now expected to average almost 6% in the first half of 2022 and remain well above the control range throughout this year. It is then expected to ease to about 2½% in the second half of 2023 and return to the 2% target in 2024."

The Bank's latest rate decision, commentary and forecasts leaves little doubt for a relatively aggressive rate cycle, particularly given expected Q2 economic growth, and there is an argument for another 50 bps in June. That said, we still forecast a series of 25 bps hikes with the policy rate reaching 2.0 per cent by year end and topping out at 2.25 per cent in 2023. There is some concern of an "increasing risk that expectations of elevated inflation could become entrenched", which runs the risk of overshooting neutral which was upward revised to 2.5 per cent.

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