(BN) Canadian Dollar and Yields Jump as Inflation Spurs Hike Bet s (1)

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2017-12-21 18:07:27.782 GMT

By Maciej Onoszko

(Bloomberg) -- Canada's dollar surged along with yields on the country's government bonds as faster-than-expected inflation and retail sales growth spurred wagers for more imminent monetary tightening.

The loonie advanced as much as 1.1 percent against the U.S. dollar, appreciating to the strongest level in two weeks and outperforming all other major currencies Thursday. Rates on Canadian bonds rose across the curve, with the two-year yield increasing to the highest level since 2011.

While the Bank of Canada has tightened monetary policy twice this year, its two most recent decisions caused traders to dial back their expectations for rate increases as policy makers stood pat and emphasized caution -- including over the future of the North American Free Trade Agreement. Yet inflation's jump above the bank's 2 percent target and a surge in retail sales to the highest level since January may push the bank to act faster than anticipated.

For more on the stronger Canadian data, click here.

"This data is strong across the board and will support the aggressive pricing for BOC tightening," said Alvise Marino, a foreign-exchange strategist at Credit Suisse Securities in New York. "We remain fundamentally bullish on the loonie, as per our three-month forecast of C$1.25 against the U.S. dollar, but I must confess I am a little surprised at how fast we are approaching that level, given the highly asymmetric nature of the potential outcomes" from next month's Nafta negotiation round, he said.

The loonie strengthened as much as 1.1 percent to C$1.2700 per dollar and was at C$1.2711 as of 1:05 p.m. in Toronto, having blasted past its 50-day moving average of C$1.2748. The currency extended its year-to-date gain to 5.7 percent, on track for its best annual performance since 2009. The yield on the country's two-year note advanced five basis points to 1.68 percent on Thursday.

The greenback-loonie pair could easily slip back to slightly above C$1.26 in the next week or so and could make one last push higher after the January BOC meeting because talk of a hike then looks premature, said Shaun Osborne, chief foreign- exchange strategist at Bank of Nova Scotia. But in his view a BOC hike in March or April looks "quite possible," the U.S. currency may have issues of its own in early 2018, and those could combine to help buoy the Canadian dollar in a few months time.

The likelihood of a rate increase at the BOC's next meeting on Jan. 17 has risen to 58 percent and the odds of a hike in the first quarter of the year are at 76 percent, based on overnight index swaps data.

All eyes will now be fixed on the October economic growth data due Friday and a report on Canada's jobs market scheduled for Jan. 5.

Doug Porter, chief economist at Bank of Montreal, still expects the central bank to "wait for a spell before hiking again" and has an increase penciled into his forecasts for March, but says "that could change quickly if those two reports also read strong."

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