CANADA PREVIEW: BoC to Walk, Not Run, Toward 2022 Rate Hike
2021-12-07 15:24:50.957 GMT

By Andrew Husby (Economist)
(Bloomberg Economics) -- Strong labor-market data means another hawkish shift is likely at the Bank of Canada's meeting Wednesday. Though the central bank will not adjust policy levers, it's likely to ratchet up tougher talk on inflation, adding to the case for a rate hike by next spring.
We recently changed our call on rate liftoff to the April 2022 meeting, a quarter earlier than before. With virus-related uncertainty elevated, the statement should open the door to a January hike but hold short of saying a move is imminent.
What we expect:
* Policy rate on hold at 0.25%. Incoming data have been consistent with the BoC's October guidance that the output gap will close in the middle quarters of 2022.
* The delta and omicron variants present downside risks to activity. That said, the jobless rate touched 6.0% in November, a level we expected would only be achieved later in 2022.
* A tighter job market plus inflation at 4.7% in October means concern about prices should feature more prominently in the statement. Our economic projections are shown in a table at the end of this note.
* There is no briefing session or updated Monetary Policy Report (MPR) accompanying this meeting.
* Deputy Governor Toni Gravelle will provide an economic progress report Dec. 9, the first chance to explain the latest decision and the bank's view of recent data. Governor Tiff Macklem is scheduled to speak Dec. 15.
* For more on Canadian rates, read Bloomberg Intelligence's preview here.

November Showed Significant Absorption of Labor Slack

Faster-than-expected job gains have been the main risk to our call that the BoC would slow-play rates liftoff. The blockbuster November report showed employment rose by 154k, more than four times as fast as the consensus expectation.
Even allowing for some reversal in contact-sensitive industries in the winter months, the remaining gap to the pre-

pandemic trend has closed quickly. We estimate the economy was about 70k jobs short of the pre-pandemic employment rate in November, as shown in the chart above.

However, we expect communications may stress inflation numbers are still tracking in line with the October MPR, giving the BoC some space to gauge virus risks ahead of the January meeting.

Firmer Inflation + Labor Gains = Hike Bets

Our policy dashboard below shows inflation well above the midpoint of the BoC’s target range of 1%-3%. Activity on a GDP basis was recovering through October, financial conditions are easy, and the U.S. recovery is still on track. As a result, market participants are pricing in more than five 25-basis point hikes in 2022.

As hikes approach, the 2-year/10-year yield curve has flattened by about 75 basis points since April. That suggests market participants do not expect the central bank to get much beyond the peak of the last hiking cycle, which topped out at 1.75%.

BoC Policy Dashboard

While an incremental hawkish shift is coming relative to the bank’s prior communications, we expect it will be a measured step. Omicron is a shared conundrum for central banks, presenting upside risks to inflation but downside risks to growth. Tightening too quickly is still a risk.

We expect this will be reflected in a gradual pace of hikes, about one per quarter once liftoff starts, with an endpoint at 2.0%.

Our projections still have inflation slowing toward 2.0%-2.5% at the end of 2022, with home-price appreciation already softening. Inflation expectations are well contained and wage expectations remain moderate, according to survey data through 3Q from the Bank of Canada.

Bloomberg Economics Canada Forecast Table

To contact the economist on this analysis:

Andrew Husby (Economist) in New York at ahusby1@bloomberg.net
To contact the editor responsible for this analysis:
Michael S. Arnold at marnold48@bloomberg.net

To view this story in Bloomberg click here:
https://blinks.bloomberg.com/news/stories/R3QZU3T1UM0W