Pervasive price pressure leads to purposeful policy
By Taylor Schleich, Warren Lovely & Jocelyn Paquet

Rate Statement

Eight weeks after July’s surprise full percentage point rate increase, the Bank of Canada opted for a consensus-matching 75 basis point rate hike this morning. This is the fifth rate increase in as many meetings, and officially brings the overnight target into restrictive territory (i.e., above the Bank’s estimated 2-3% neutral range). Interestingly, there was no reference of the ‘front-loading’ approach that we saw in the July decision. That said, we don’t read too much into this from a policy guidance perspective but instead see it as the Bank backing away from a poor choice of words.

As for explicit guidance for future meetings, the statement notes that “Given the outlook for inflation, the Governing Council still judges that the policy interest rate will need to rise further” (language similar to July’s statement). The statement now adds: “As the effects of tighter monetary policy work through the economy, we will be assessing how much higher interest rates need to go to return inflation to target”. So clearly rates need to continue rising, but there is a subtle nod to data dependency that suggests the pace of rate increases might be adjusted downward going forward.

When it comes to the BoC’s balance sheet, there’s again nothing new to report here. With the April decision ushering in the start of quantitative tightening, balance sheet run-off remains on autopilot, complementing increases in the policy rate.

As for the economic outlook, there are no new projections released today (those will come via an updated Monetary Policy Report in late October). That said, the statement did speak to recent developments. Notably, it conceded that all-items inflation has eased but the statement largely downplayed this, citing falling gas prices as a key driver and highlighting that there has been a further broadening of price pressures. The Bank also referenced surveys that suggest short-term inflation expectations remain high, which increases the risk that elevated inflation becomes entrenched. Meanwhile, last week’s sub-consensus growth data was “somewhat weaker than the Bank had projected” but “indicators of domestic demand were very strong” and the “Canadian economy continues to operate in excess demand”. Finally, the Bank once again downplayed the housing market slowdown, noting that the pullback is “as anticipated following unsustainable growth during the pandemic”.

There will be no press conference today, but Senior Deputy Governor Carolyn Rogers will deliver an Economic Progress Report tomorrow morning (speech text released at 11:25 AM EST and press conference at 1:00 PM EST).

Bottom Line:

While there was an especially large range of outcomes going into today’s meeting, the headline decision came out as expected. Nonetheless, we’d consider this statement to be on the hawkish end of the spectrum. The Bank poured cold water on the “pause” narrative as they made it clear that rates will need to rise further still. How much further has intentionally been left open to debate, but do we sense a bit more of a ‘data dependent’ tone (“we will be assessing how much higher interest rates need to go”). Consistent with rates now being in restrictive territory, we’d expect a downshift in the pace of policy rate increases ahead. For now, the debate is likely to be centered on 50 basis points for the next meeting (i.e., anywhere from 25 bps to 75 bps appears to be on the table compared to 50 bps to 100 bps today). Incoming data (most importantly will be two CPI reports) should have a significant influence on the late-October decision but the focus here will be core/services inflation as they’ll be looking through any relief brought on by falling gas prices. We’ll reserve final judgement on our expected path for policy until we hear from Senior Deputy Governor Rogers tomorrow but clearly, the Bank does not intend today’s hike to be its last. As they reiterated today, the BoC is “resolute” in their commitment to price stability, and they’ll do what it takes to get inflation back to 2%. For now, prices are anything but stable, which has meant decidedly purposeful policy decisions.

The Bank’s next policy meeting is scheduled for October 26th and will be published alongside an updated Monetary Policy Report.
Here is the interest rate statement:

Bank of Canada increases policy interest rate by 75 basis points, continues quantitative tightening

The Bank of Canada today increased its target for the overnight rate to 3¼%, with the Bank Rate at 3½% and the deposit rate at 3¼%. The Bank is also continuing its policy of quantitative tightening.

The global and Canadian economies are evolving broadly in line with the Bank’s July projection. The effects of COVID-19 outbreaks, ongoing supply disruptions, and the war in Ukraine continue to dampen growth and boost prices.

Global inflation remains high and measures of core inflation are moving up in most countries. In response, central banks around the world continue to tighten monetary policy. Economic activity in the United States has moderated, although the US labour market remains tight. China is facing ongoing challenges from COVID shutdowns. Commodity prices have been volatile: oil, wheat and lumber prices have moderated while natural gas prices have risen.

In Canada, CPI inflation eased in July to 7.6% from 8.1% because of a drop in gasoline prices. However, inflation excluding gasoline increased and data indicate a further broadening of price pressures, particularly in services. The Bank’s core measures of inflation continued to move up, ranging from 5% to 5.5% in July. Surveys suggest that short-term inflation expectations remain high. The longer this continues, the greater the risk that elevated inflation becomes entrenched.

The Canadian economy continues to operate in excess demand and labour markets remain tight. Canada’s GDP grew by 3.3% in the second quarter. While this was somewhat weaker than the Bank had projected, indicators of domestic demand were very strong – consumption grew by about 9½% and business investment was up by close to 12%. With higher mortgage rates, the housing market is pulling back as anticipated, following unsustainable growth during the pandemic. The Bank continues to expect the economy to moderate in the second half of this year, as global demand weakens and tighter monetary policy here in Canada begins to bring demand more in line with supply.

Given the outlook for inflation, the Governing Council still judges that the policy interest rate will need to rise further. Quantitative tightening is complementing increases in the policy rate. As the effects of tighter monetary policy work through the economy, we will be assessing how much higher interest rates need to go to return inflation to target. The Governing Council remains resolute in its commitment to price stability and will continue to take action as required to achieve the 2% inflation target.

Information note

The next scheduled date for announcing the overnight rate target is October 26, 2022. The Bank will publish its next full outlook for the economy and inflation, including risks to the projection, in the MPR at the same time.
Economics and Strategy

Montreal Office
514–879–2529

Stéfane Marion
Chief Economist and Strategist
stefane.marion@nbc.ca

Matthieu Arseneau
Deputy Chief Economist
matthieu.arseneau@nbc.ca

Kyle Dahms
Economist
kyle.dahms@nbc.ca

Daren King
Economist
daren.king@nbc.ca

Jocelyn Paquet
Economist
jocelyn.paquet@nbc.ca

Alexandra Ducharme
Economist
alexandra.ducharme@nbc.ca

Angelo Katsoras
Geopolitical Analyst
angelo.katsoras@nbc.ca

Toronto Office
416–869–8598

Warren Lovely
Chief Rates and Public Sector Strategist
warren.lovely@nbc.ca

Taylor Schleich
Rates Strategist
taylor.schleich@nbc.ca

General

This Report was prepared by National Bank Financial, Inc. (NBF), (a Canadian investment dealer, member of IIROC), an indirect wholly owned subsidiary of National Bank of Canada. National Bank of Canada is a public company listed on the Toronto Stock Exchange.

The particulars contained herein were obtained from sources which we believe to be reliable but are not guaranteed by us and may be incomplete and may be subject to change without notice. The information is current as of the date of this document. Neither the author nor NBF assumes any obligation to update the information or advise on further developments relating to the topics or securities discussed. The opinions expressed are based upon the author(s) analysis and interpretation of these particulars and are not to be construed as a solicitation or offer to buy or sell the securities mentioned herein, and nothing in this Report constitutes a representation that any investment strategy or recommendation contained herein is suitable or appropriate to a recipient's individual circumstances. In all cases, investors should conduct their own investigation and analysis of such information before taking or omitting to take any action in relation to securities or markets that are analyzed in this Report. The Report alone is not intended to form the basis for an investment decision, or to replace any due diligence or analytical work required by you in making an investment decision.

This Report is for distribution only under such circumstances as may be permitted by applicable law. This Report is not directed at you if NBF or any affiliate distributing this Report is prohibited or restricted by any legislation or regulation in any jurisdiction from making it available to you. You should satisfy yourself before reading it that NBF is permitted to provide this Report to you under relevant legislation and regulations.

National Bank of Canada Financial Markets is a trade name used by National Bank Financial and National Bank of Canada Financial Inc.

Canadian Residents

NBF or its affiliates may engage in any trading strategies described herein for their own account or on a discretionary basis on behalf of certain clients and as market conditions change, may amend or change investment strategy including full and complete divestment. The trading interests of NBF and its affiliates may also be contrary to any opinions expressed in this Report.

NBF or its affiliates often act as financial advisor, agent or underwriter for certain issuers mentioned herein and may receive remuneration for its services. As well NBF and its affiliates and/or their officers, directors, representatives, associates, may have a position in the securities mentioned herein and may make purchases and/or sales of these securities from time to time in the open market or otherwise. NBF and its affiliates may make a market in securities mentioned in this Report. This Report may not be independent of the proprietary interests of NBF and its affiliates.

This Report is not considered a research product under Canadian law and regulation, and consequently is not governed by Canadian rules applicable to the publication and distribution of research Reports, including relevant restrictions or disclosures required to be included in research Reports.
UK Residents
This Report is a marketing document. This Report has not been prepared in accordance with EU legal requirements designed to promote the independence of investment research and it is not subject to any prohibition on dealing ahead of the dissemination of investment research. In respect of the distribution of this Report to UK residents, NBF has approved the contents (including, where necessary, for the purposes of Section 21(1) of the Financial Services and Markets Act 2000). This Report is for information purposes only and does not constitute a personal recommendation, or investment, legal or tax advice. NBF and/or its parent and/or any companies within or affiliates of the National Bank of Canada group and/or any of their directors, officers and employees may have or may have had interests or long or short positions in, and may at any time make purchases and/or sales as principal or agent, or may act or may have acted as market maker in the relevant investments or related investments discussed in this Report, or may act or have acted as investment and/or commercial banker with respect hereto. The value of investments, and the income derived from them, can go down as well as up and you may not get back the amount invested. Past performance is not a guide to future performance. If an investment is denominated in a foreign currency, rates of exchange may have an adverse effect on the value of the investment. Investments which are illiquid may be difficult to sell or realise; it may also be difficult to obtain reliable information about their value or the extent of the risks to which they are exposed. Certain transactions, including those involving futures, swaps, and other derivatives, give rise to substantial risk and are not suitable for all investors. The investments contained in this Report are not available to retail customers and this Report is not for distribution to retail clients (within the meaning of the rules of the Financial Conduct Authority). Persons who are retail clients should not act or rely upon the information in this Report. This Report does not constitute or form part of any offer for sale or subscription of or solicitation of any offer to buy or subscribe for the securities described herein nor shall it or any part of it form the basis of or be relied on in connection with any contract or commitment whatsoever.

This information is only for distribution to Eligible Counterparties and Professional Clients in the United Kingdom within the meaning of the rules of the Financial Conduct Authority. NBF is authorised and regulated by the Financial Conduct Authority and has its registered office at 70 St. Mary Axe, London, EC3A 8BE.

NBF is not authorised by the Prudential Regulation Authority and the Financial Conduct Authority to accept deposits in the United Kingdom.

U.S. Residents
With respect to the distribution of this report in the United States of America, National Bank of Canada Financial Inc. ("NBCFI") which is regulated by the Financial Industry Regulatory Authority (FINRA) and a member of the Securities Investor Protection Corporation (SIPC), an affiliate of NBF, accepts responsibility for its contents, subject to any terms set out above. To make further inquiry related to this report, or to effect any transaction, United States residents should contact their NBCFI registered representative.

This report is not a research report and is intended for Major U.S. Institutional Investors only.

This report is not subject to U.S. independence and disclosure standards applicable to research reports.

HK Residents
With respect to the distribution of this report in Hong Kong by NBC Financial Markets Asia Limited ("NBCFMA") which is licensed by the Securities and Futures Commission ("SFC") to conduct Type 1 (dealing in securities) and Type 3 (leveraged foreign exchange trading) regulated activities, the contents of this report are solely for informational purposes. It has not been approved by, reviewed by, verified by or filed with any regulator in Hong Kong. Nothing herein is a recommendation, advice, offer or solicitation to buy or sell a product or service, nor an official confirmation of any transaction. None of the products issuers, NBCFMA or its affiliates or other persons or entities named herein are obliged to notify you of changes to any information and none of the foregoing assume any loss suffered by you in reliance of such information. The content of this report may contain information about investment products which are not authorized by SFC for offering to the public in Hong Kong and such information will only be available to, those persons who are Professional Investors (as defined in the Securities and Futures Ordinance of Hong Kong ("SFO")). If you are in any doubt as to your status you should consult a financial adviser or contact us. This material is not meant to be marketing materials and is not intended for public distribution. Please note that neither this material nor the product referred to is authorized for sale by SFC. Please refer to product prospectus for full details.

There may be conflicts of interest relating to NBCFMA or its affiliates’ businesses. These activities and interests include potential multiple advisory, transactional and financial and other interests in securities and instruments that may be purchased or sold by NBCFMA or its affiliates, or in other investment vehicles which are managed by NBCFMA or its affiliates that may purchase or sell such securities and instruments.

No other entity within the National Bank of Canada group, including National Bank of Canada and National Bank Financial Inc., is licensed or registered with the SFC. Accordingly, such entities and their employees are not permitted and do not intend to: (i) carry on a business in any regulated activity in Hong Kong; (ii) hold themselves out as carrying on a business in any regulated activity in Hong Kong; or (iii) actively market their services to the Hong Kong public.

Copyright
This Report may not be reproduced in whole or in part, or further distributed or published or referred to in any manner whatsoever, nor may the information, opinions or conclusions contained in it be referred to without in each case the prior express written consent of NBF.