November 18, 2026

Tightening Tendencies II: How hikes hit the economy

By Taylor Schleich & Warren Lovely

We published the first installment of our three-part *Tightening Tendencies* series in mid-October, in anticipation of a tightening cycle that *we thought* would begin in December. Governor Macklem had other plans and quickly pulled forward hike expectations before delivering a rate increase late last month. With that, a new Bank of Canada tightening cycle—the eighth in the last thirty years—is officially underway.

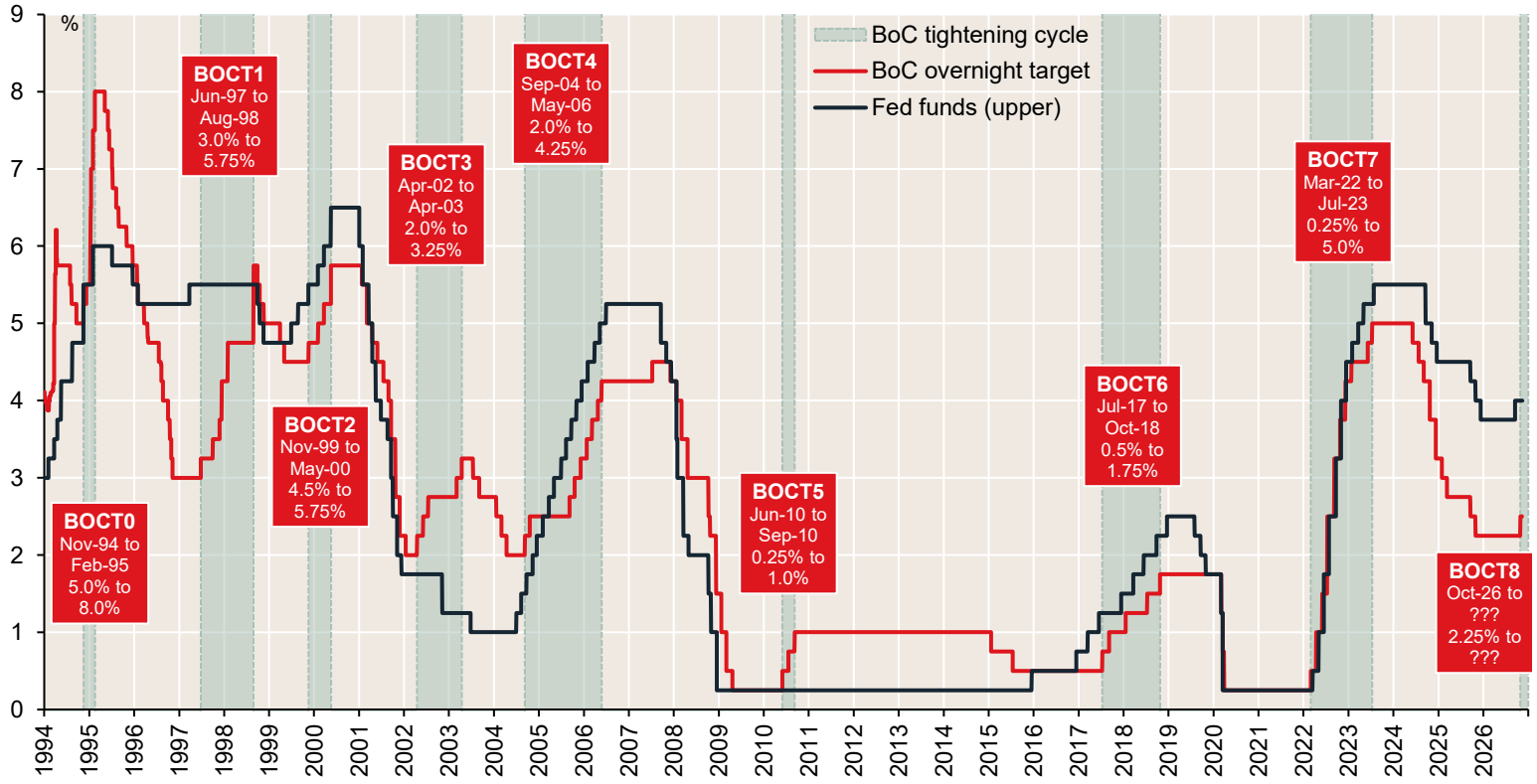
In Part II of our series, we look at the economic context surrounding historical hiking cycles and how today's environment compares. No two cycles are identical, but there are some informative takeaways from the 'average' experience across the last seven tightening campaigns:

- Today's 3.1% inflation rate is the second hottest reading to start a cycle. The record, of course, came in 2022 with CPI near 6% at liftoff.
- On average, inflation peaks a year after the first hike. The BoC thinks inflation will top out in early 2027, but we think the peak is already in. To us, the bigger question is: how steep will the descent be?
- Core inflation is generally tame when hikes begin, except for in 2022. Excluding that extraordinary cycle, core tends to stay near 2% after tightening starts. Today, core is also contained but the BoC is trying to be forward-looking to stop energy inflation from broadening out.
- The BoC has tightened with labour market slack before, and the job market has generally proven resilient. In each of the past seven cycles, the jobless rate declined in the year after the first hike.
- It's rarer to begin tightening with a negative output gap, as is the case today. In the past, hikes have not immediately yielded slack given monetary policy lags. On average, growth slows but remains positive.
- Canada's economy is more interest-rate-sensitive than that of the U.S. due to a greater reliance on residential investment. Historically, it's here (and in interest-rate-sensitive demand more broadly) where tightening impacts are the clearest. Today, housing is *already* historically weak, and material hikes could weaken it even further.
- Households may be more rate-sensitive than in the past given the growing popularity of variable-rate mortgages and shorter-term fixed rate mortgages (see a related **Hot Chart**). From this perspective, hikes may 'bite' sooner. Fortunately, indebtedness across the country has improved from five years ago. But even with this deleveraging, Canadians carry more debt than Americans, as has long been true.

*Note: **Part I** of our Tightening Tendencies series can be found **here**. **Part III** is forthcoming and will examine financial market performance before, during and after each hiking campaign.*

Chart 1: Over thirty years of overnight rate targeting in North America, keying on BoC tightening cycles

Bank of Canada overnight rate target and Federal Reserve fed funds target (upper), identifying distinct BoC monetary policy tightening cycles

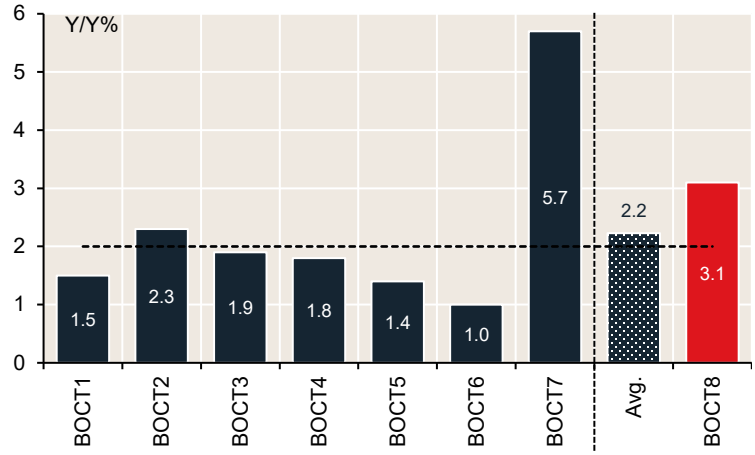


Source: NBC, BoC, FRB, BBG, StatCan

Chart 1 is a holdover from the first installment of our series. We don't generally favour duplication, but this is vital context. In addition, the chart looks a bit different than in Part I given that the Bank began a new tightening cycle in between publication dates. Where this cycle terminates is still uncertain, but this is likely to be on the shorter end of the spectrum as far as magnitude is concerned. Pacing is also up in the air. We've leaned toward the Bank going relatively quickly, delivering another hike in December. But recent data has generally been soft, which perhaps argues for graduality.

Chart 2: Today's inflation is high for the start of a cycle

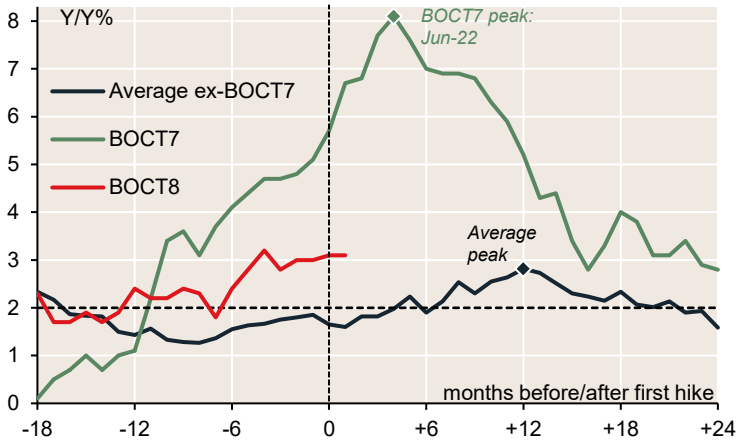
All-items CPI inflation in month before first hike



Source: NBC, StatCan

Chart 3: It can take some time for inflation to cool

Evolution of all-items CPI inflation before/after 1st hike: BOCT7, prior cycle avg.

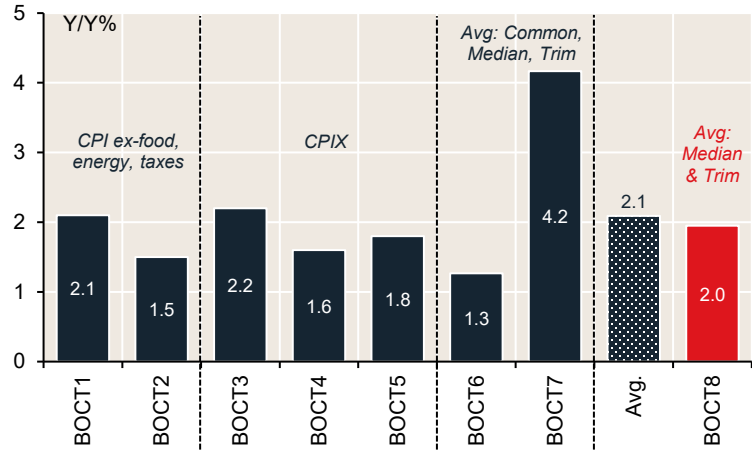


Source: NBC, StatCan | Note: T=0 refers to month before first hike.

Relative to 2022, today's 3.1% inflation rate is tame. But this is well above the starting point for inflation in all prior cycles. On average, inflation continues to rise after the first hike and peaks about a year later. But last cycle was quicker as inflation peaked in June 2022 after hikes began in March. That quicker turnaround is similar to the BoC's latest MPR, which sees CPI peaking in Q1 2027.

Chart 4: Outside 2022, core generally less problematic

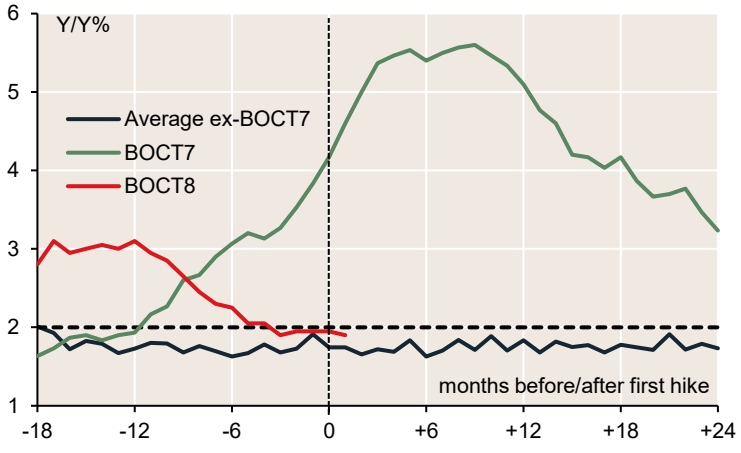
Bank of Canada preferred core inflation indicator in month before first hike



Source: NBC, StatCan, BoC

Chart 5: Historically, core stayed in a narrow band (ex-2022)

Evolution of BoC preferred core inflation indicator before/after 1st hike

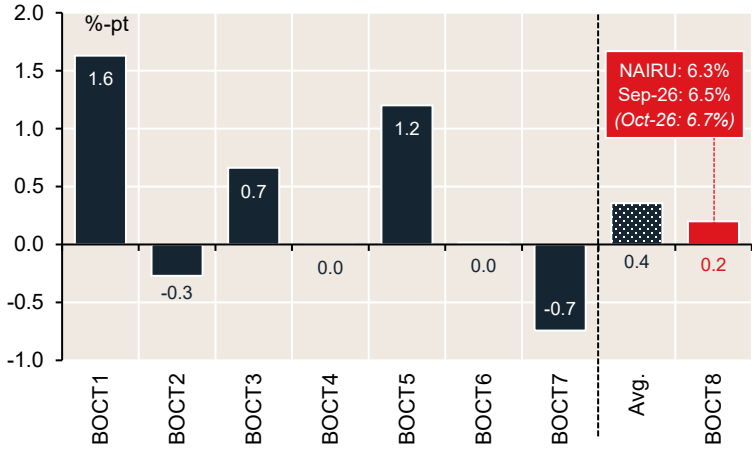


Source: NBC, StatCan | Note: T=0 refers to month before first hike.

The BoC doesn't often tighten because of steamy core inflation. Excluding 2022, core inflation averaged 1.7% before the first hike, not too dissimilar from today. Last cycle was different: core inflation didn't peak until November 2022, well after rate hikes began. Fortunately, that experience is an outlier. On average, core inflation hovers in a narrow range near 2% during and after the hiking cycle.

Chart 6: The BoC has hiked with far more job market slack...

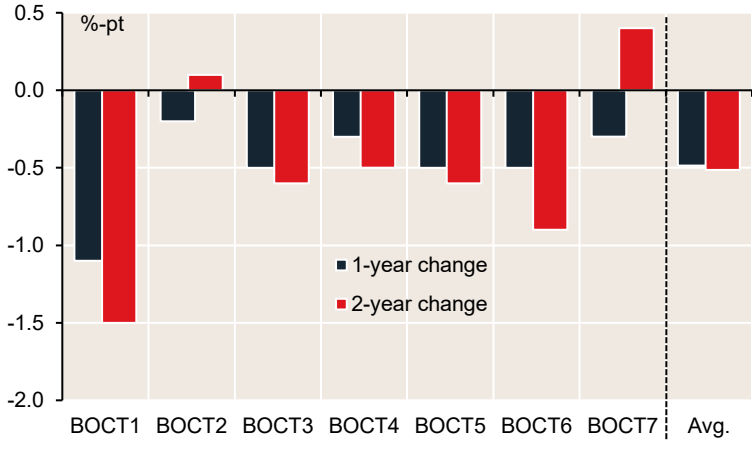
Unemployment rate less NAIRU in the month before start of hiking cycle



Source: NBC, StatCan, BoC, OECD | Note: Pre-2026 NAIRU via OECD; 2026 via BoC.

Chart 7: The labour market often resilient in face of hikes

1- and 2-year change in unemployment rate after first hike of cycle

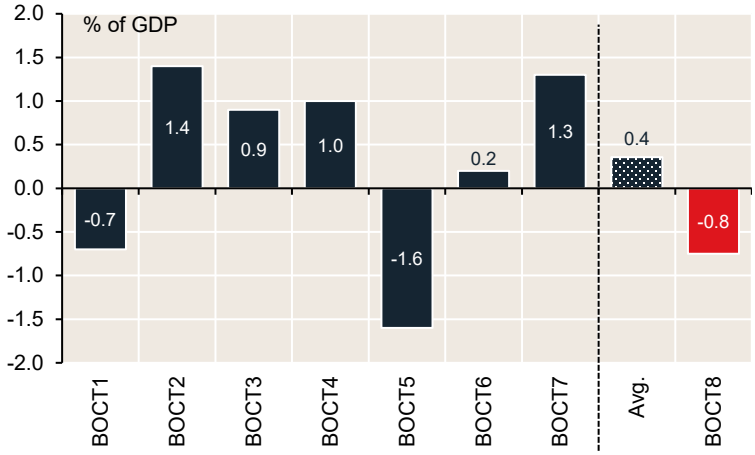


Source: NBC, StatCan | Note: Reference period is one month before first hike

Today, the jobless rate is 0.4%-pts above the BoC's NAIRU estimate. That's about normal and the Bank has hiked with more slack before. Fortunately, labour markets have held up well in the early stages of tightening. The jobless rate has *never* been higher one year after the first hike and is, on average, 0.5%-pts *lower*. Last cycle, it took 20 months to return to the Feb-22 unemployment rate.

Chart 8: It's rarer to start hiking with a negative output gap

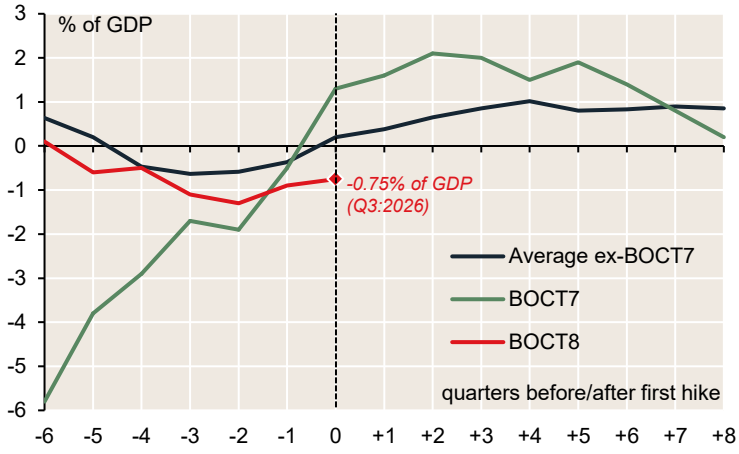
Bank of Canada estimate of output gap in quarter before start of tightening cycle



Source: NBC, BoC | Note: BOCT8 = midpoint of BoC 2026:Q3 estimate (-1.25% to -0.25%)

Chart 9: Hikes don't immediately yield negative output gap

Trajectory of Canada output gap before/after tightening cycle begins

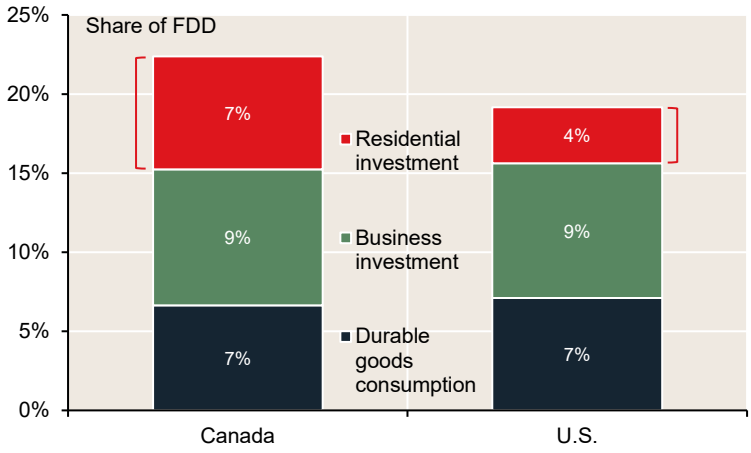


Source: NBC, BoC | Note: BOCT8 = midpoint of BoC 2026:Q3 estimate (-1.25% to -0.25%)

While the BoC has hiked with *job market* slack, tightening into a negative output gap is rarer. Only twice has the Bank hiked with as much or more slack than today: In 1997 (the Asian financial crisis and a plunging loonie) and in 2010 (3 hikes from 0.25%). Notably, hikes don't immediately lead to slack. On average, the output gap grows *more positive* in the initial quarters after the cycle begins.

Chart 10: Canada is more rate-sensitive than the U.S., but…

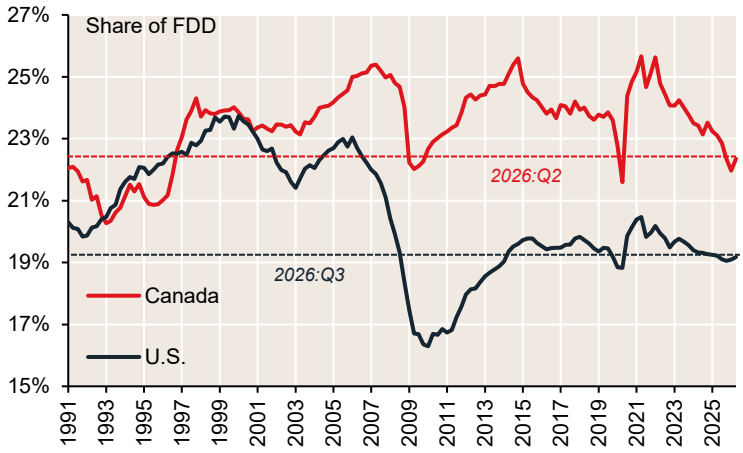
Interest-rate-sensitive demand share of final domestic demand (FDD): Latest qtr



Source: NBC, StatCan, BEA | Note: Canada = Q2:2026, U.S. = Q3:2026

Chart 11: …Canada's rate sensitivity has eased since 2022

Interest-rate-sensitive demand share of final domestic demand (FDD)

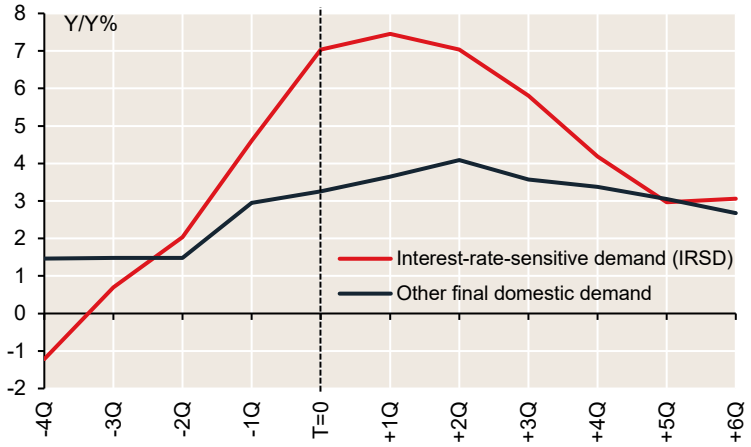


Source: NBC, StatCan, BEA

Hikes may not stop GDP growth, but interest-rate-sensitive demand is more vulnerable. As has long been true, Canada is more rate-sensitive than the U.S., due largely to the housing market. True, Canada's rate sensitivity eased after the last hiking cycle hit real estate hard. But even after that correction, Canadian residential investment is nearly 2X that of the U.S. as share of the economy.

Chart 12: IRSD brought to heel in 4-6 quarters

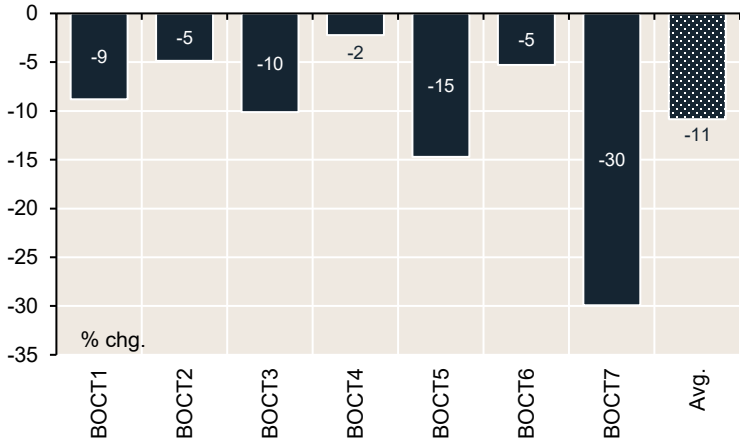
Average growth in Canadian IRSD vs. other FDD before/after BoC hiking cycles



Source: NBC, StatCan

Chart 13: Housing activity is quickest to respond

Change in existing home sales: 6M after first hike vs. 6M before first hike

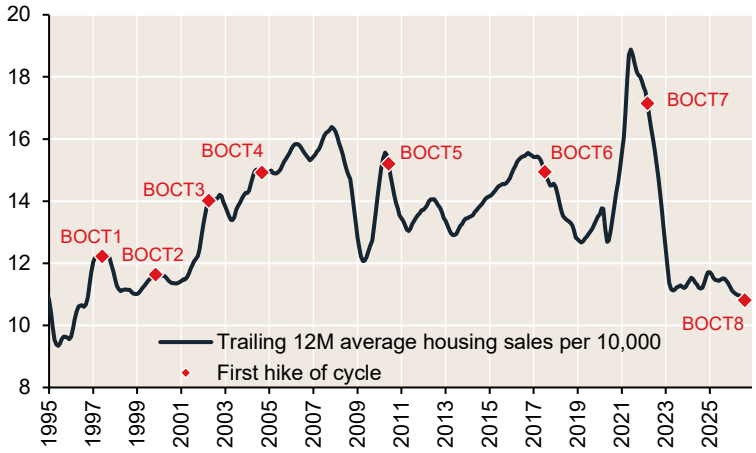


Source: NBC, CREA

Intuitively, rate hikes cool interest-rate-sensitive demand. On average, growth in these segments is brought to heel within 4–6 quarters, broadly in line with conventional monetary policy lags. But some subsectors react even faster. Housing is the obvious example. Resale activity has fallen in the six months following the first hike in every tightening cycle, by 11% on average and 30% in 2022.

Chart 14: Today, the housing market is already weak…

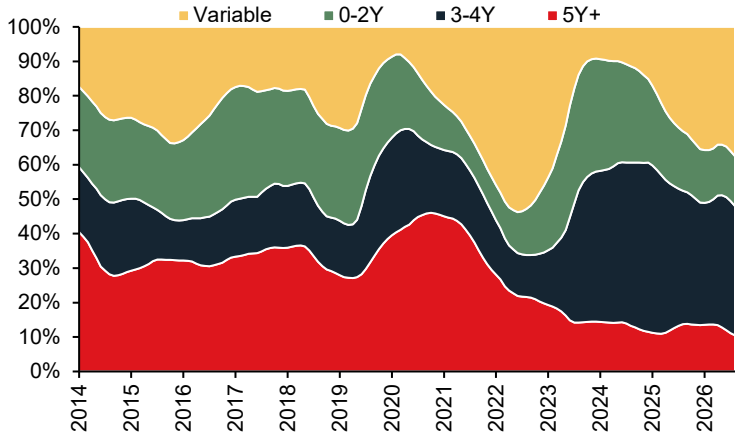
Seasonally adjusted housing sales (12M MA) per ten thousand residents



Source: NBC, CREA, StatCan | Note: Scaled by working age population

Chart 15: …with homeowners more exposed to rate hikes

Share of mortgage funds advanced by term/mortgage type (12M MA)

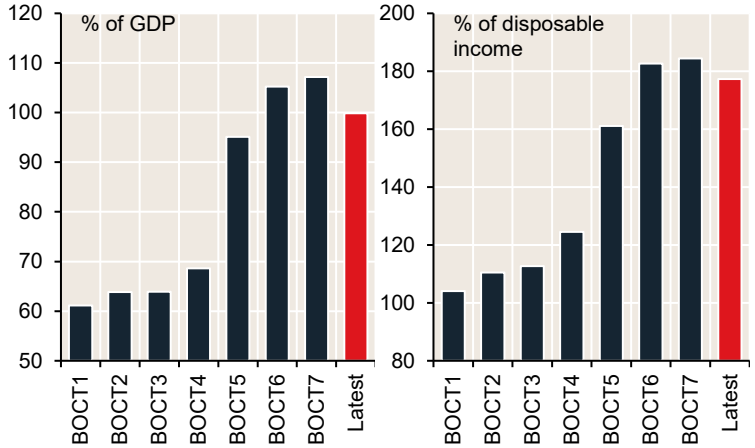


Source: NBC, BoC

Today, housing activity is already weak, so a dose of rate hikes may deliver another blow to a sector already on the ropes. Another vulnerability: A growing share of Canadians are opting for variable-rate or shorter-term fixed mortgages (rather than 5Y fixed), speeding up policy transmission. Still, households proved resilient to seismic hikes in '22–23, and this cycle should pack less of a punch.

Chart 16-17: Households have deleveraged since 2022

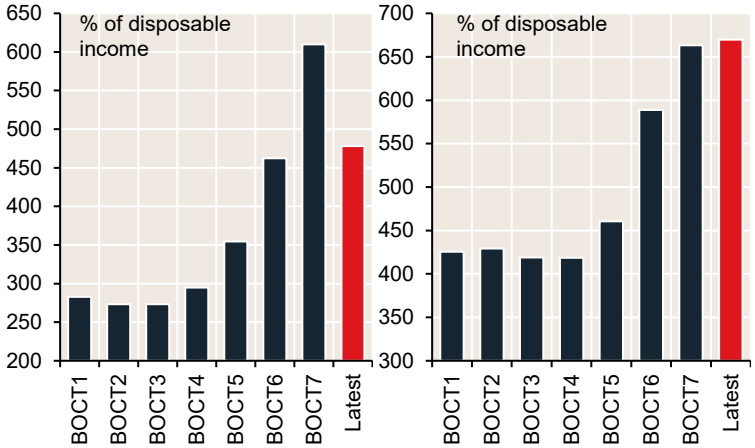
Household debt-to-GDP (Left) | Household debt-to-disposable income (Right)



Source: NBC, StatCan | Note: Levels for quarter before start of cycle (Latest = Q2:26)

Chart 18-19: Financial asset gains cushion the housing hit

Real estate (Left) and financial assets (Right) as a share of disposable income

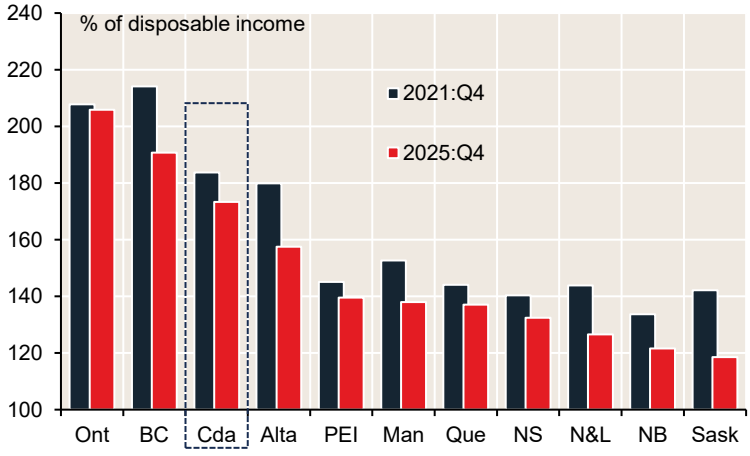


Source: NBC, StatCan | Note: Levels for quarter before start of cycle (Latest = Q2:26)

After decades of Canadians taking on more leverage, household balance sheets have improved in recent years. Today, leverage is lower than at the start of the last two hiking cycles. In 2021-22, real estate prices were stretched and have fallen materially since. That's helpful for affordability. But even for existing homeowners, less home equity is mitigated by strong financial asset performance.

Chart 20: After deleveraging, debt still varies regionally

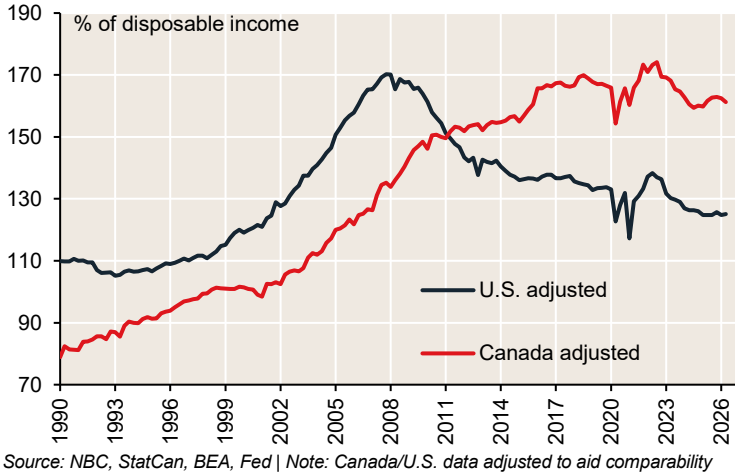
Household debt-to-disposable income ratio by province



Source: NBC, StatCan | Note: Sorted in descending order based on latest data (2025:Q4)

Chart 21: Canada remains more indebted than the U.S.

NBC-adjusted household debt-to-disposable income: Canada & U.S.



Source: NBC, StatCan, BEA, Fed | Note: Canada/U.S. data adjusted to aid comparability

Households deleveraged across all provinces since COVID, by varying degrees. BC no longer carries the heaviest debt burden. That honour now belongs to Ontario. Versus Ontario & BC, debt burdens are much lighter in Quebec, Atlantic Canada and the Prairies. But Canadians are still more indebted than Americans. This implies a larger economic drag for a given amount of tightening.

Economics and Strategy

Subscribe to our publications:
NBC.EconomicsStrategy@nbc.ca

To contact us:
514-879-2529

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

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

Jocelyn Paquet
Senior Economist
jocelyn.paquet@nbc.ca

Kyle Dahms
Senior Economist
kyle.dahms@nbc.ca

Alexandra Ducharme
Senior Economist
alexandra.ducharme@nbc.ca

Daren King, CFA
Senior Economist
daren.king@nbc.ca

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

Taylor Schleich
Rates Strategist
taylor.Schleich@nbc.ca

Ethan Currie
Strategist
ethan.currie@nbc.ca

Angelo Katsoras
Geopolitical Analyst
angelo.katsoras@nbc.ca

Nathalie Girard
Senior Coordinator
n.girard@nbc.ca

Giuseppe Saltarelli
Desktop Publisher
giuseppe.saltarelli@nbc.ca

General: This Report was prepared by National Bank Financial, Inc. (NBF), (a Canadian investment dealer, member of CIRO), 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.

EU Residents: With respect to the distribution of this report in the member states of the European Union ("EU") and the European Economic Area ("EEA") by NBC Paris, the contents of this report are for information purposes only and do not constitute investment advice, investment research, financial analysis or other forms of general recommendation relating to transactions in financial instruments within the meaning of Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 ("MiFID 2"). This report is intended only for professional investors and eligible counterparties within the meaning of MiFID 2 and its contents have not been reviewed or approved by any EU/EEA authority. NBC Paris is an investment firm authorised by the French Prudential Control and Resolution Authority __ ("ACPR") to provide investment services in France and has passported its investment services throughout the EU/EEA under the freedom to provide services and has its registered office at 8 avenue Percier, 75008 Paris, France. "NBC Financial Markets, a subsidiary of National Bank of Canada" is a trade name used by NBC Paris S.A.

NBF is not authorised to provide investment services in the EU/EEA.

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.