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Bank of Canada announcement

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Today's half point rate hike wasn't a half measure in the Bank of Canada's battle against inflation, because in short order, we'll likely see another move of the same magnitude. The 50 basis point move, taking the overnight rate to 1.5%, was well telegraphed, as was the Bank of Canada's well-reasoned decision to further reduce monetary stimulus. This was yet another larger-than-normal hike, so to justify it, Macklem's team couldn't mince words about their concern over inflationary pressures. Its statement cited the likelihood of even higher inflation in the near term, and the broadening nature of price gains. Global growth indicators might be slowing, but Canada is described as "strong" and expected to be "solid" in the second quarter, leaving it in "excess demand", the Bank's term for overheating. There was no announced change to its plans for quantitative tightening, which will let its bond holdings roll off with maturities.

Other than when rates are near zero or at a clear turning point, Canada's central bankers aren't inclined to give detailed forward guidance. Our call for another 50 basis point hike in July would fit the definition for the forceful measures it has talked about. There was, however, a threat to act "more forcefully if needed", and no counterbalancing hint of a potential need to slow the pace of hikes. That runs counter to our forecast that we'll see signs of a growth deceleration by early fall, allowing the BoC to slow to a 25 bp hike in September, and then a pause before a final quarter point to 2.5% in early 2023.

But with another half point hike on tap for July, likely with more stern language from the Bank of Canada, we expect more of May's flight-to-safety rally in bonds to be reversed over the summer if equities can even manage to level off. Lower long-term rates will be more readily sustained if and when see evidence of tamer growth and inflation, a development to look for come this fall.

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