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## Bank of Canada: Marching higher in March

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The Bank of Canada has delivered the first step towards taking some steam out of the economy, in an effort to wrestle inflation back under control. Today's quarter point rate hike was well telegraphed, and the pace of hikes in Canada is likely to be mirrored by what the Fed delivers stateside. While some will claim to be shocked at how hawkish the accompanying statement reads, they shouldn't be, as its primary purpose is to explain to Canadians why the pain of higher interest rates is warranted. The Bank of Canada has never launched a tightening cycle with anything other than positive statement about growth and a strong case that rate hikes are needed to contain inflation. If anything, the Bank opted to be less aggressive by maintaining its practice of reinvesting maturing bonds for now, although we expect them to cease doing so after the April meeting.

- So why now and not back in January? The key is that unlike two month's ago, the Bank can now point to data showing that "the rebound from Omicron appears to be well in train" and that would presumably include both evidence from declining hospitalizations, but also the news of a full reopening in previously shuttered or capacity-limited services. Moreover, the economy has proven to be a bit more resilient to Covid's impacts, aside from the jobs decline in January that looks likely to be reversed by March. The Bank described both Q4 and projected Q1 growth as stronger than they expected, and sees inflation also set to top their last forecast. The only real cloud mentioned on the growth front was the Ukraine war, which is seen as "new source of uncertainty" that will be "followed closely", but also as a lift to inflation.
- If we have a slight critique of the Bank's approach to getting going on a tightening cycle, it would be about today's decision to continue reinvesting maturing Government of Canada bonds in its portfolio into new securities. We see no obvious logic in helping the bond market hold down yields through such purchases, while simultaneously trying to raise interest rates by lifting the overnight rate. Why push and pull at the same time? Perhaps it wants to use the opportunity afforded by April's Monetary Policy Report, and the formal press conference that accompanies its release, to lay out the details of its quantitative tightening strategy.
- As we had expected, the Bank has taken itself out of the forward guidance game. Unlike the Fed, Canada's central bank tends to eschew providing any specifics on its intentions other than when has reached the lower bound on the policy rate. The most it will reveal is that rates "will need to rise further", and that those decisions, along with the timing of quantitative tightening, will be aimed at hitting its inflation target.

## Implications & actions

**Re: Economic forecast** — With the CPI likely to run hotter than we had expected through the first half of the year, odds are that the Bank will deliver the remaining three quarter point hikes we had allocated for 2022 over the next three rate setting dates, rather than spread out through the year. We expect it to then pause at a 1.25% overnight rate to take stock of the direction for growth and inflation, and to let quantitative tightening operate as a tool for adjusting policy, before resuming rate hikes in 2023.

**Re: Markets** — Other than its deferral of a decision on quantitative tightening, the Bank didn't give markets much in the way of real news, as a rate hike was widely expected, and its description of the growth and inflation picture not too surprising for anyone following the data in recent weeks. Yields further out the curve have fallen in the days since the onset of war on a flight to safety bid impacting the global bond market, but are unlikely to sustain these lower rates in the face of the tightening ahead from both the Bank of Canada and the Fed. Indeed, the lower starting point for bond yields should, if anything, allow both of these central banks to give a green light to paring back their own bond holdings in the coming year.



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