



Laurentian Bank Securities ECONOMIC RESEARCH AND STRATEGY

Hawkish Speech by BoC Senior Deputy Governor Carolyn Wilkins

Good morning, market participants were caught off guard on Monday as BoC Senior Deputy Carolyn Wilkins delivered a hawkish speech. Supported by a broadly based economic growth story, the talk of the town is that the BoC may raise its policy rate this year rather than in 2018. In our view, Wilkins' speech included a new form of forward guidance in order to prevent markets from pricing 3-4 hikes within the next 12-18 months: *"An important aspect of our inflation assessment is that the economic drag from lower oil prices is now largely behind us. And the 50 basis point reduction in our policy rate in 2015 has facilitated this adjustment. As growth continues and, ideally, broadens further, Governing Council will be assessing whether all of the considerable monetary policy stimulus presently in place is still required".* Accordingly, the BoC is more comfortable with the idea of removing, partially or totally, this 50 bps reduction (which included the 25 bps "insurance cut" of January 2015). If markets fully understand this forward guidance, Canada's 2-year bond yield should not go significantly above 1.00% for instance.

The biggest surprise in our view is that the BoC is suddenly ready to move away from the sidelines despite the considerable uncertainty regarding the impact of Trump's policies on the Canadian economy: *"This will likely remain an important uncertainty in our projection, but life goes on and decisions must be made in the meantime".* The BoC is less patient, unwilling to wait until 2018 (as we were previously expecting) before lifting its 0.50% policy rate. Wilkins said that *"If you saw a stop light ahead, you would begin letting up on the gas to slow down smoothly"... "You don't want to have to slam on the brakes at the last second. Monetary policy must also anticipate the road ahead."*

Bottom Line: BoC Governor Poloz said in an interview with CBC Radio this morning that *"rate cuts have largely done their work"*, reaffirming Wilkins' hawkish tone. Clearly, our previous forecast of no change for the overnight rate target for the next 18 months has become obsolete. Besides the Canadian broadly based growth story, the gradual hiking process at the Fed also makes it easier for the BoC to consider hiking sooner than later without leading to an excessive appreciation of the CAD. Thus, one 25 bps hike is more likely to occur at the September 6th or October 25th meeting, once markets fully understand the BoC's new rhetoric with the release of the *MPR* on July 12th. Investors will also pay attention to Governor Poloz's remarks in Portugal on June 28th. Deputy Governor Lynn Patterson speaks in Calgary the same day.

Echoing Janet Yellen's previous comment regarding FOMC decisions, markets understand now that every meeting is "live" at the BoC as well. This being said, a second 25 bps hike will be more difficult to justify since most of the indicators of inflation pressures fail to indicate an inflation surge in the medium-term in our view. Indeed, we are far from convinced that CPI inflation will firmly move toward the 2% target (similar to the U.S.) As the CAD appreciation will keep some CPI components in check, the elevated debt burden, on-going adjustment in the housing sector and the historically low wage growth will also call for the BoC to remain prudent in its eventual hiking process.

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