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Posthaste: Why the Bank of Canada will likely raise interest rates again — and maybe again

One and done? Not likely, say economists and the market which predicts one, maybe two, more hikes

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Many economists expect Bank of Canada governor Tiff Macklem to raise interest rates at least one more time. PHOTO BY ADRIAN WYLD/CANADIAN PRESS/BLOOMBERG

The Bank of Canada surprised markets by raising its benchmark interest rate last week, but is this a ‘one and done’?

Not likely, say economists.

The Bank left little doubt about where it stood in the announcement of the June 7 hike to 4.75 per cent.

“Overall, excess demand in the economy looks to be more persistent than anticipated,” the Bank said in its official statement. “The bank remains resolute in its commitment to restoring price stability for Canadians.”

Price stability for the Bank of Canada means the two per cent inflation target, and we’re a long way from that.

Randall Bartlett, senior director of Canadian Economics at Desjardins said the Bank’s statement leaves the door open for another rate hike when it next meets on July 12 if the economy doesn’t change direction.

And Desjardins economists are skeptical the Canadian economy will lose much momentum between now and then.

Gross domestic product came in much stronger than expected in the first quarter. The 3.1 per cent reading not only beat economists’ expectations, but also the Bank of Canada’s own forecast of 2.3 per cent.

But it was Statistics Canada’s early estimate of 0.2 per cent growth month over month in April that really raised eyebrows. Economic activity in this month was hit by severe ice storms in central Canada and the federal public services strike. If these one-off events hadn’t occurred, growth would have been even stronger, wrote Bartlett.

May GDP should show a rebound in the sectors affected by these setbacks, driving the economic momentum well into the second quarter, he said.

Alberta wildfires shut down some oil production temporarily but the energy sector still managed to post a modest gain in May, high-frequency data suggest, Bartlett said. In fact, after a strong April, mining and oil and gas are set to be growth leaders in the second quarter.

Then there is the housing market.

Home sales “defied gravity” in April and judging by early indications in May as well, Bartlett said. One reason the housing market has rebounded so quickly is that a large portion of variable-rate borrowers have yet to feel the full impact of rising rates because some banks are tacking the rise in payments onto the principal. “But one can only kick the housing correction can down the road so far. Ultimately, lenders will want to get paid," he said.

Desjardins economists are now predicting 2 per cent annualized growth for the second quarter, higher than the Bank of Canada's 1 per cent forecast. Some of that momentum is likely to carry over into the third quarter.

Jobs data that came out two days after the Bank hiked last week was softer than expected, but economists caution against putting too much weight on one reading.

"It is highly unlikely that the Bank of Canada chose to interrupt the pause in interest rates that started in January for just the one additional 25 basis point interest rate hike announced earlier this week," wrote RBC assistant chief economist Nathan Janzen after the jobs data.

"One softer employment report doesn't make a new trend, and labour markets are still exceptionally tight from a historical perspective."

Headline inflation is expected to continue to decelerate, but the underlying inflation that the Bank of Canada looks at appears stuck between 3.5 and 4.5 per cent.

"With inflation expectations having moved higher since the April MPR, the Bank's job of bringing inflation back to 2 per cent looks to be getting harder by the day," said Desjardins' Bartlett.

"This poses a significant challenge for the Bank of Canada — one that prompted the rate hike this week and will likely lead to another in July and possibly thereafter."

The market agrees. Last week traders had priced almost two more hikes into the market, said mortgage analyst Rob McLister in his newsletter Mortgagelogic.news.

"It's nothing short of shock-and-awe for many floating-rate borrowers who — despite BoC messaging — thought we were at a peak."

Canada's unemployment rate ticked up to 5.2 per cent in May, data showed Friday, the first increase in almost a year. Two days earlier the Bank of Canada had hiked its key rate to 4.75 per cent, citing a stronger-than-expected economy and labour market.

"That's a reminder," writes CIBC chief economist Avery Shenfeld, "that we can't be too sure about when the cumulative impact of a steep climb in rates in the past year might start to show up in the data, even if it hasn't yet."

The 17,300 jobs lost in May were cracks appearing in Canada's labour market, but probably not enough to persuade the Bank of Canada that inflation has significantly cooled, wrote CIBC economist Andrew Grantham.

There is still another jobs report, inflation report and the Bank of Canada's Business Outlook Survey before the next interest rate decision on July 12.

Economists expect it will take more downbeat readings to prevent another rate hike.