

International Commentary — March 31, 2022

Strong Economy and Rapid Inflation Support Bank of Canada's Hawkish Tack

Summary

- The Bank of Canada (BoC) recently kicked off its tightening cycle with a 25 bps rate hike in early March. Alongside the rate hike, BoC policymaker commentary has shifted in a more hawkish direction. Recent economic figures, particularly inflation and labor market data, support this more hawkish stance in BoC monetary policy.
- Given elevated inflation, a solid labor market and hawkish central bank, we expect the Bank of Canada to lift policy rates more aggressively than previously anticipated. We now forecast a 25 bps rate hike at each of the remaining six BoC policy meetings this year and for the policy rate to end 2022 at 2.00%. We expect tightening to continue into 2023, and believe interest rates will rise to 2.75% by the end of next year.
- **Given our revised BoC outlook, we believe the Canadian dollar could be one of the more resilient G10 currencies in the quarters ahead. In addition to higher policy rates, elevated oil prices should also act as a pillar of support to the Canadian dollar going forward, and underpins our view for only modest Canadian dollar softness versus the greenback.**

Economist(s)

Nick Bennenbroek

International Economist | Wells Fargo Economics
Nicholas.Bennenbroek@wellsfargo.com | 212-214-5636

Brendan McKenna

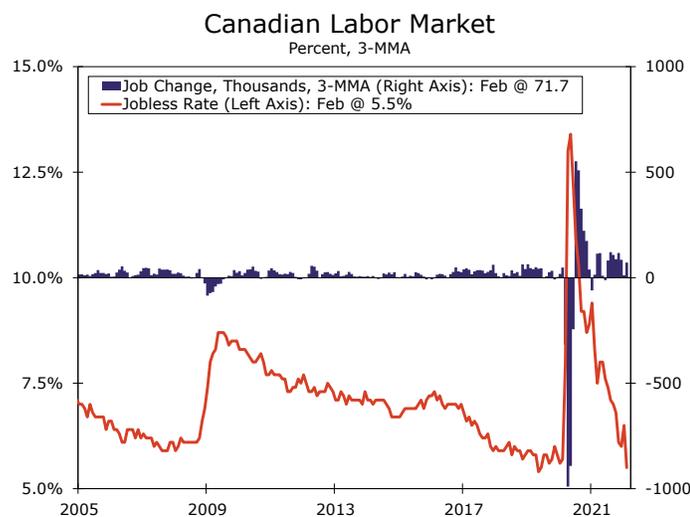
International Economist | Wells Fargo Economics
Brendan.Mckenna@wellsfargo.com | 212-214-5637

Bank of Canada Kicks Off Rate Hike Cycle

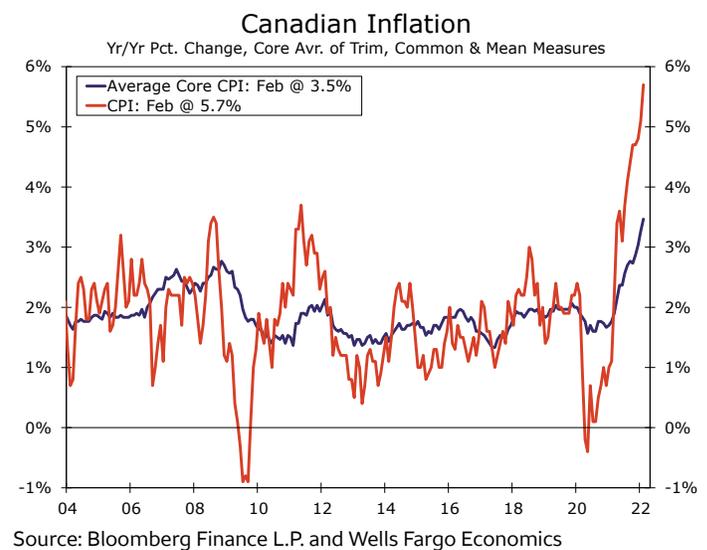
The Bank of Canada (BoC) kicked off its rate hike cycle in early March, with a 25 bps policy rate hike to 0.50%. The central bank's accompanying comments were also hawkish in tone. Among other things the BoC said:

- Fourth quarter GDP growth was stronger than projected, and confirms the view that economic slack has been absorbed. The BoC also said Q1-2022 growth is looking more solid than previously projected.
- Price increases have become more pervasive, and measures of core inflation have all risen, and that "persistently elevated inflation is increasing the risk that longer-run inflation expectations could drift upwards."
- As the economy continues to expand and inflation pressures remain elevated, the Governing Council expects interest rates will need to rise further.

Since that early March announcement, a broad range of data have supported the central bank's hawkish outlook. Importantly, the February employment report suggested the economy is rebounding quite strongly from a brief Omicron related slowdown early this year. February employment jumped by 336,600 jobs, more than reversing the January decline. The details showed full-time jobs rising by 121,500 and part-time jobs rising by 215,100. The unemployment rate also fell to 5.5%. Other indicators of economic resilience include an increase in the February manufacturing PMI to 60.6, and a 3.2% month-over-month gain in January retail sales. Moreover, overall GDP managed to eke out a 0.2% month-over-month gain in January, with the flash estimate for GDP to rise 0.8% in February.



Source: Datastream and Wells Fargo Economics



Source: Bloomberg Finance L.P. and Wells Fargo Economics

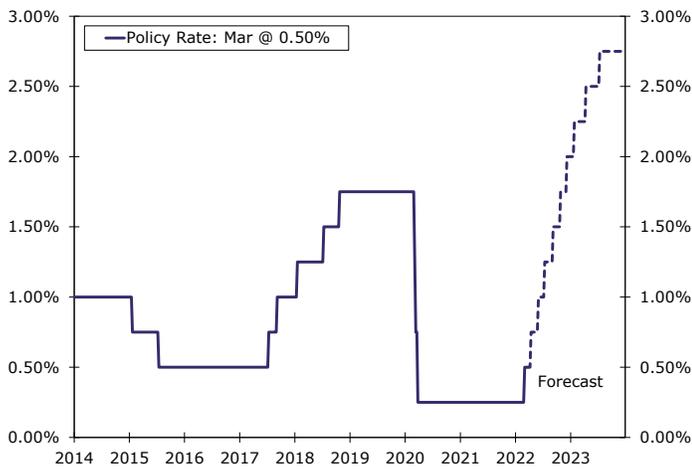
Robust Data Supports the Bank of Canada's Hawkish Outlook

In addition to robust activity data, the February CPI also showed a marked firming of inflation. The headline CPI quickened more than expected to 5.7% year-over-year, in part on higher food and energy prices. However, it was not just oil and other commodity prices that drove inflation higher, as the average of the central bank's core inflation measures also firmed slightly to 3.5% year-over-year. Given the subsequent increase in oil and other commodity prices in the wake of the Russia-Ukraine conflict, Canadian inflation should accelerate even further in March.

In fact, given resilient activity data and rising inflation, Bank of Canada policymakers have offered some further hawkish comments in recent weeks. Bank of Canada deputy governor Kozicki said she expects the pace and magnitude of future rate hikes, and well as quantitative tightening, will be discussed during April deliberations. She also warned the Russia-Ukraine conflict is driving inflation higher than the central bank's most recent quarterly forecasts. Kozicki's comments clearly bring the possibility of a larger 50 bps increase into play at the upcoming Bank of Canada monetary policy meetings. While our base case does not yet incorporate a 50 bps hike, following robust activity, rapid inflation and a hawkish central bank over the past several weeks, **we now envisage much faster tightening from**

the Bank of Canada than previously. We forecast a 25 bps policy rate increase at each of the six remaining policy announcements this year (compared to a total of three previously), which would see the policy rate finish 2022 at 2.00%. In 2023, we expect another three 25 bps rate increases, lifting the policy rate to 2.75% by the end of next year. From a currency perspective, with the pace of Bank of Canada tightening now expected to more closely match that of the Fed over time, we see only moderate softness in the Canadian dollar versus the U.S. currency over the medium-term. Elevated oil prices should also offer another pillar of support for the Canadian dollar.

Bank of Canada Policy Rate



Source: Bloomberg Finance L.P. and Wells Fargo Economics

Subscription Information

To subscribe please visit: www.wellsfargo.com/economicsemail

Via The Bloomberg Professional Services at WFRE

Economics Group

| | | | |
|----------------------|--------------------------|--------------|-------------------------------------|
| Jay H. Bryson, Ph.D. | Chief Economist | 704-410-3274 | Jay.Bryson@wellsfargo.com |
| Mark Vitner | Senior Economist | 704-410-3277 | Mark.Vitner@wellsfargo.com |
| Sam Bullard | Senior Economist | 704-410-3280 | Sam.Bullard@wellsfargo.com |
| Nick Bennenbroek | International Economist | 212-214-5636 | Nicholas.Bennenbroek@wellsfargo.com |
| Tim Quinlan | Senior Economist | 704-410-3283 | Tim.Quinlan@wellsfargo.com |
| Sarah House | Senior Economist | 704-410-3282 | Sarah.House@wellsfargo.com |
| Azhar Iqbal | Econometrician | 212-214-2029 | Azhar.Iqbal@wellsfargo.com |
| Charlie Dougherty | Economist | 212-214-8984 | Charles.Dougherty@wellsfargo.com |
| Michael Pugliese | Economist | 212-214-5058 | Michael.D.Pugliese@wellsfargo.com |
| Brendan McKenna | International Economist | 212-214-5637 | Brendan.Mckenna@wellsfargo.com |
| Shannon Seery | Economist | 332-204-0693 | Shannon.Seery@wellsfargo.com |
| Nicole Cervi | Economic Analyst | 704-410-3059 | Nicole.Cervi@wellsfargo.com |
| Sara Cotsakis | Economic Analyst | 704-410-1437 | Sara.Cotsakis@wellsfargo.com |
| Jessica Guo | Economic Analyst | 704-410-4405 | Jessica.Guo@wellsfargo.com |
| Karl Vesely | Economic Analyst | 704-410-2911 | Karl.Vesely@wellsfargo.com |
| Patrick Barley | Economic Analyst | 704-410-1232 | Patrick.Barley@wellsfargo.com |
| Coren Burton | Administrative Assistant | 704-410-6010 | Coren.Burton@wellsfargo.com |

Required Disclosures

This report is produced by the Economics Group of Wells Fargo Bank, N.A. ("WFBNA"). This report is not a product of Wells Fargo Global Research and the information contained in this report is not financial research. This report should not be copied, distributed, published or reproduced, in whole or in part. WFBNA distributes this report directly and through affiliates including, but not limited to, Wells Fargo Securities, LLC, Wells Fargo & Company, Wells Fargo Clearing Services, LLC, Wells Fargo Securities International Limited, Wells Fargo Securities Europe S.A., Wells Fargo Securities Canada, Ltd., Wells Fargo Securities Asia Limited and Wells Fargo Securities (Japan) Co. Limited. Wells Fargo Securities, LLC is registered with the Commodity Futures Trading Commission as a futures commission merchant and is a member in good standing of the National Futures Association. WFBNA is registered with the Commodity Futures Trading Commission as a swap dealer and is a member in good standing of the National Futures Association. Wells Fargo Securities, LLC and WFBNA are generally engaged in the trading of futures and derivative products, any of which may be discussed within this report.

This publication has been prepared for informational purposes only and is not intended as a recommendation offer or solicitation with respect to the purchase or sale of any security or other financial product nor does it constitute professional advice. The information in this report has been obtained or derived from sources believed by WFBNA to be reliable, but has not been independently verified by WFBNA, may not be current, and WFBNA has no obligation to provide any updates or changes. All price references and market forecasts are as of the date of the report. The views and opinions expressed in this report are not necessarily those of WFBNA and may differ from the views and opinions of other departments or divisions of WFBNA and its affiliates. WFBNA is not providing any financial, economic, legal, accounting, or tax advice or recommendations in this report, neither WFBNA nor any of its affiliates makes any representation or warranty, express or implied, as to the accuracy or completeness of the statements or any information contained in this report and any liability therefore (including in respect of direct, indirect or consequential loss or damage) is expressly disclaimed. WFBNA is a separate legal entity and distinct from affiliated banks and is a wholly owned subsidiary of Wells Fargo & Company. © 2022 Wells Fargo Bank, N.A.

Important Information for Non-U.S. Recipients

For recipients in the United Kingdom, this report is distributed by Wells Fargo Securities International Limited ("WFSIL"). WFSIL is a U.K. incorporated investment firm authorized and regulated by the Financial Conduct Authority ("FCA"). For the purposes of Section 21 of the UK Financial Services and Markets Act 2000 ("the Act"), the content of this report has been approved by WFSIL, an authorized person under the Act. WFSIL does not deal with retail clients as defined in the Directive 2014/65/EU ("MiFID2"). The FCA rules made under the Financial Services and Markets Act 2000 for the protection of retail clients will therefore not apply, nor will the Financial Services Compensation Scheme be available. For recipients in the EFTA, this report is distributed by WFSIL. For recipients in the EU, it is distributed by Wells Fargo Securities Europe S.A. ("WFSE"). WFSE is a French incorporated investment firm authorized and regulated by the Autorité de contrôle prudentiel et de résolution and the Autorité des marchés financiers. WFSE does not deal with retail clients as defined in the Directive 2014/65/EU ("MiFID2"). This report is not intended for, and should not be relied upon by, retail clients.

SECURITIES: NOT FDIC-INSURED - MAY LOSE VALUE - NO BANK GUARANTEE