Instant Thoughts

7 September 2017

Bank of Canada Is Not Done Tightening

- Catching the market off guard, the BoC announced to lift its overnight cash rate by 25bp to 1.0%, the second hike in a row.
- Still, we believe the Bank is not done tightening. With an impressive print of over 3.5% GDP growth for the first half, Q3 growth is likely to stay well above BoC’s estimates for potential growth of 1.0-1.5%. Besides, the weakness in inflation and wage growth has been put to the sideline yet again. We expect the Bank to hike its rates by another 25bp before the year end.
- Similar to the ECB, the BoC is not unlikely to “talk down” the loonie. The only headwind is the stretched long-CAD positioning built up so far. But from a risk/reward point of view, we still prefer to buy dips as long as the rate-hike story remains “live” and the trend line is not clearly broken.

The turbulence that we expected to be a recurring feature for the markets at the end of summer wasted no time in arriving yesterday. While most economist had anticipated the Bank of Canada to stay put this month, the Bank clearly saw no need to postpone the action. The BoC announced to lift its overnight cash rate by 25bp to 1.0%, the second hike in a row.

Solid growth makes policymakers comfortable

The Bank said to give particular focus to the “evolution of the economy’s potential”, which leads us to conclude outperformance of the Canadian economy was the main justification for yesterday’s decision.

The Bank has now taken back its 50-bp “insurance cuts” in response to the oil price shock of 2014/2015. What’s next? We still believe the Bank is not done tightening. With an impressive print of over 3.5% GDP growth for the first half, Q3 growth is likely to stay well above BoC’s estimates for potential growth of about 1.0-1.5%. In BoC’s
own words, “growth in Canada is becoming more broadly-based and self-sustaining.” Besides, the weakness in inflation and wage growth has been put to the sideline yet again. It seems to us the Bank leans to the view that low inflation is a pervasive issue globally and to certain extent, outside of its ability to control.

As such, the Bank described today’s hike as the removal of “some of the considerable monetary policy stimulus in place.” Indeed, the back-to-back rate hike reveals its ambition to push the policy rate towards neutral, which is estimated to lie between 2.5% and 3.5%. We thus expect the Bank to hike its rates by another 25bp before the year end.

**Door for further appreciation left open**

Catching the market off guard, the USDCAD gapped lower from 1.24 to 1.22 on the decision. Similar to the ECB, the BoC is not unlikely to “talk down” the loonie. The Bank did cite the stronger FX rate in the post-meeting statement, but they did not express any serious concern about the rally. The only headwind is the stretched long-CAD positioning built up so far. But from a risk/reward point of view, we still prefer to buy dips as long as the rate-hike story remains “live” and the trend line is not clearly broken.
Recent Publications

Debt Ceiling a Perennial Problem         Sep 5, 2017
Too Soon To Call It a Turning Point       Aug 30, 2017
A Dawn for Momentum Investing           Aug 24, 2017
Nuclear Jitters                          Aug 17, 2017
The HKMA Is Removing the Punch Bowl      Aug 9, 2017
How High Can Euro Go? A Rate Spread Perspective  Aug 4, 2017
Dovish Was the Market’s Read            Jul 27, 2017
What Can We Learn from Quant Strategy   Jul 26, 2017
Hold Your Fire                           Jul 21, 2017
Higher Yield, Tighter Spreads            Jul 20, 2017
Bank of Canada Pulled the Plug           Jul 13, 2017
Why Doesn’t Higher Yield Steer Dollar    Jul 12, 2017
Fortuitous Summer Break                   Jul 3, 2017
Proxy Hedge                              Jun 27, 2017
Poor Inflation did not deter Federal Reserve   Jun 15, 2017
Conservatives Short of Majority          Jun 9, 2017
Keep a Close Eye on the UK General Election  Jun 7, 2017
Our Take On Moody’s Rating Actions       May 25, 2017
Could Trump Be Impeached?                May 25, 2017
Canadian Dollar for Sell                 May 18, 2017
Launch of China Hong Kong Bond Connect    May 17, 2017
Debunking Sell in May and Go Away        May 9, 2017
Confident Fed Chose Not to Show Its Hand  May 4, 2017
The Uneven Impact of Trump’s Tax Plan    May 2, 2017
Quick Thoughts on the French Election    Apr 24, 2017
Commodity Prices Surge, Will Currencies Follow? Apr 19, 2017
The Coming Government Shutdown          Apr 6, 2017
The Fed’s Next Move                      Mar 23, 2017
A Much-Heralded Rate Hike                Mar 16, 2017
Timing Matters                           Mar 14, 2017
Can the Aussie Rally Last?               Mar 2, 2017
The Ins and Outs of the French Presidential Elections  Feb 23, 2017
Offshore Renminbi Market at Crossroad    Feb 9, 2017
No Fireworks at Fed Meeting              Feb 2, 2017
Disclaimer - Investment Involves Risk

Investment involves risks, investors may be subject to substantial losses. The exchange rates of any currencies or the price and income of any securities, funds, bonds or other financial instruments described herein may fall as well as rise. Past performance should not be taken as an indication of future performance.

RMB is currently not freely convertible, the exchanges of RMB are subject to a daily limit imposed by Chinese and Hong Kong regulatory and supervisory authorities. RMB convertibility from offshore RMB (CNH) to onshore RMB (CNY) is a managed currency process subject to foreign exchange control policies of and restrictions imposed by the Chinese government. There can be no assurance that RMB will not be subject to devaluation at some point.

Any projections and opinions expressed herein are expressed solely as general market commentary and do not constitute investment advice or guaranteed return. Shanghai Commercial Bank Limited and its affiliates may trade for their own account in, may have a position in, all or any of the currencies, securities or investments mentioned in this document. Customers are advised to make an independent review and reach their own decisions regarding the economic benefits and risks of any transaction and the legal, regulatory, credit, tax and financial aspects of such transaction relating to their particular circumstances. Neither the information nor any opinions contained herein constitutes a solicitation or offer by Shanghai Commercial Bank Limited to buy or sell, whether as principal or agent, any currencies exchange, securities, funds, futures, options or other financial instruments or provide any service or investment advice.

Although the information herein contained is obtained or compiled from sources we believe to be reliable, Shanghai Commercial Bank Limited cannot and does not warrant the accuracy, validity, reliability, timeliness or completeness of any such information. Shanghai Commercial Bank Limited expressly disclaims any warranties of fitness for a particular purpose or duties of care and accepts no liability (whether in tort or contract or otherwise) for any loss or damages arising from any use of, or inaccuracies or omissions of the information. All information is provided “as is”, and is subject to change without prior notice. The information herein contained may not be reproduced, distributed or published in any medium for any purpose without prior express written consent from Shanghai Commercial Bank Limited. The information herein contained has not been reviewed by the Hong Kong Securities and Futures Commission.