Inflation data eyed as BoC tilts to raising interest rate

By John Heinzl
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Let the rate-hike guessing game begin.

Now that the Bank of Canada has signalled that it's preparing to raise its benchmark interest rate for the first time in seven years, economists will be watching the flow of data – including reports on inflation and retail sales this week – for clues about when the central bank will finally pull the trigger.

Last week, Bank of Canada senior deputy governor Carolyn Wilkins said the drag from lower oil prices is now "largely behind us" and that growth is broadening across regions and economic sectors. In light of the economy's strength, she said the bank will be "assessing whether all of the considerable monetary policy stimulus presently in place is still required."

Prior to Ms. Wilkins's speech, the market wasn't expecting the bank to hike its key overnight rate – currently 0.5 per cent – until 2018 at the earliest. But with her bullish comments, the outlook has shifted dramatically.

"The market is now pricing in at least one rate hike by the end of this year and another by the end of next year," Michael Gregory, deputy chief economist with BMO Nesbitt Burns, said in a note.

BMO doesn't expect an increase until early in 2018, but Mr. Gregory said there is a possibility that the central bank could move in October, or even as early as July.

The timing will depend to a great extent on what the economic data say.

On Friday, Statistics Canada releases the consumer price index for May, providing the latest read on inflation – a key factor the bank considers when setting monetary policy.

"While headline inflation could decelerate a tick, some improvement in core measures will help solidify the new market expectation for a [Bank of Canada] hike before the end of the year," Andrew Grantham, economist with CIBC World Markets, said in a note.

CIBC expects the headline CPI to post a year-over-year increase of 1.5 per cent in May, down slightly from 1.6 per cent in April, reflecting lower gasoline prices. But it said inflation could pick up in the second half of the year on higher food prices and the general strength of the economy.

Food could also figure prominently in this week's CPI report.

Food "tends to be strong in May, and could nearly end the deflation in that sub-index that we've seen for the past seven months. Also watch for a big gain in home replacement costs after the new home price index surged in the prior month," said BMO senior economist Benjamin Reitzes.

Even though the various core CPI measures tracked by the central bank have remained tame, "given the [Bank of Canada's] recent change of tone, further softness will likely be overlooked, while a surprise strong print will increase the chatter around the potential for a July hike," Mr. Reitzes said.

Still, some economists are skeptical that this week's data will support the case for a rate hike.

"The ink is barely dry on the Bank of Canada's more hawkish bias shift and, lo and behold, [this] week's data could well be of the somewhat more dovish variety," Derek Holt, head of capital markets economics at Bank of Nova Scotia, said in a note. ScotiaBank sees inflation remaining tame – it forecasts that the

CPI will rise just 1.3 per cent year-over-year in May – and also expects Thursday's report on April retail sales to be soft.

Reflecting lower volumes of new car and trucks sold during the month, Scotiabank predicts that retail sales will be flat in April compared to March and up just 0.2 per cent excluding automobiles. BMO and CIBC both see headline retail sales rising 0.3 per cent.

In the United States – where the Federal Reserve last week raised its benchmark lending rate by a quarter-point – it's a busy week for Fed speakers, including Fed vice-chair Stanley Fischer, who will give a speech from Amsterdam early Tuesday morning.

"Particularly interesting will be whether the comments … echo the lack of concern [Fed chair] Janet Yellen appears to have regarding the deceleration in core inflation," said CIBC's Mr. Grantham.

The U.S. economic data calendar is relatively quiet, with existing home sales and new home sales, both for May, to be released on Wednesday and Friday, respectively.

With the end of the second quarter less than two weeks away, investors will be watching for any changes in earnings guidance as companies prepare to report their quarterly numbers.

According to FactSet Research, the estimated earnings growth rate for the S&P 500 currently stands at 6.5 per cent.

The biggest contributor to that increase might come as a surprise: energy.

Energy's strength reflects two factors: easy comparisons to last year's depressed earnings, and a slight year-over-year increase in the price of oil. As FactSet pointed out, even though oil prices have fallen recently, the average price per barrel of about $49 (U.S.) in the second quarter to date is still higher than the average price of about $49.60 in the second quarter of 2016.

Cost-cutting has also helped energy companies' bottom lines. On a dollar basis, the energy sector is expected to report earnings of $9.6-billion in the second quarter, up from $1.9-billion a year earlier, FactSet said.

Excluding energy, the S&P 500's estimated earnings growth rate would fall to 3.6 per cent.

On the earnings calendar, FedEx Corp. and Lennar Corp. are scheduled to report on Tuesday, Oracle Corp on Wednesday and BlackBerry Ltd. on Friday.