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Dear Clients,

I found this article in the Financial Post yesterday; for my February mailout I wanted to pass it along. Please always take these articles with a grain of salt as we all know not all economist are right. The reason I thought this was interesting is because it's the first time in a long time that anyone has mentioned increasing rates as soon as April.

Source: (Financial Post

Canadians may need to brace themselves for higher borrowing costs earlier than expected.

That's the message from economists at some of Canada's largest banks after a report Friday showed gross domestic product grew more quickly than anticipated at the end of 2020, even amid a new wave of lockdowns. The numbers are calling into question whether a first-quarter contraction will materialize after all, and leading analysts to suggest growth in 2021 could be stronger than earlier believed.

They also threaten to put pressure on the Bank of Canada to reconsider how quickly it expects to withdraw stimulus.

The central bank has pledged to keep interest rates near zero until slack is fully absorbed, something it doesn't see happening until 2023. But stronger growth could lead to an economy running at full capacity earlier than the two-year timeline, which may prompt policy makers to bring rate hike expectations forward.

The data carry "potentially strong policy implications for the Bank of Canada that is increasingly looking as if it over-committed itself to keeping rates on hold until 2023," Derek Holt, an economist at Bank of Nova Scotia, said in a report to investors. "The prudent thing to advise heavily indebted Canadians is to plan their finances around rate hikes commencing considerably sooner."

The bank has held its overnight interest rate at a record low 0.25 per cent since March to spur lending in the economy. Interest rates that commercial banks give to their prime customers are typically just over 2 percentage points above the policy rate.

To stoke demand for credit, Macklem has also committed to not raising interest rates until damage to the economy from the pandemic is fully repaired. With the recovery

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stalling over the winter because of the lockdowns, that wasn't expected to happen for another two years.

But the Canadian economy appears to be coping much better with the second wave of COVID-19 than the central bank expected as recently as this month.

Output grew about 8 per cent annualized in the fourth quarter, according to estimates released Friday from Statistics Canada. That topped the central bank's 4.8 per cent projection released on Jan. 20.

The better economic outlook could prompt Governor Tiff Macklem to indicate as early as April a quicker liftoff in rates, Simon Deeley, a fixed income strategist at Royal Bank of Canada, said in a report Friday.

"If the starting point is better," Deeley said, referring to stronger fourth-quarter numbers, "then an earlier elimination of slack is a natural conclusion."

Another concern for Macklem could be plans by Prime Minister Justin Trudeau's government to move ahead with additional stimulus, according to economists at Canadian Imperial Bank of Commerce. If the economy is in better shape than expected, that extra spending may simply add to the pressure on the Bank of Canada.

"Add enough to demand after 2021, and the economy might be closing in on full employment, with additional government spending being offset by an earlier need to hike interest rates to contain inflation," Avery Shenfeld, chief economist at CIBC, said in a report.

Finance Minister Chrystia Freeland has said she plans to spend another $70 billion to $100 billion over the next three years to help the recovery.