

POLICY COMMENTARY · JUNE BOC PREVIEW

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The Bank of Canada is set to hold in June.

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THE TAKE

“We expect the central bank to hold for a fifth straight meeting on Wednesday. Looking further out, markets are pricing too many hikes: inflation persistence isn’t showing up in the data, and our estimate of the bank’s internal rate path settles 25 to 50 basis points below what the market expects.”

— JAY ZHAO-MURRAY · CHIEF ECONOMIST · SIBLEY CREEK

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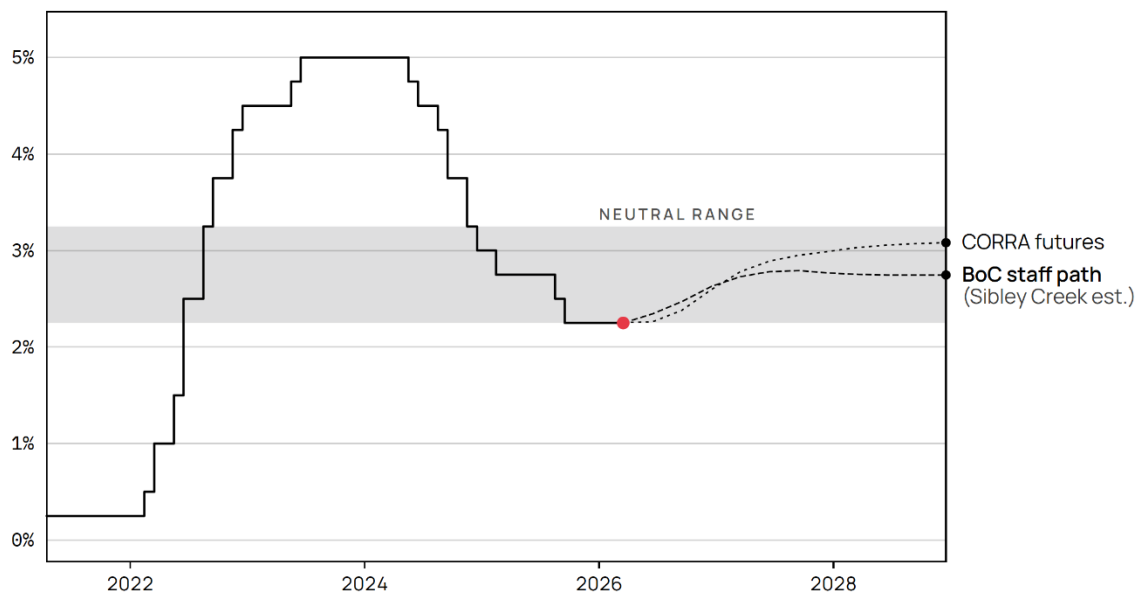
Bank of Canada will likely stay on hold for a fifth consecutive meeting.

The Bank of Canada meets this Wednesday and is widely expected to keep rates on hold at 2.25% for a fifth straight meeting. Policy currently sits at the more stimulative end of the Bank’s neutral range. We have no reason to disagree with the consensus view on Wednesday’s meeting, but we think the market is pricing in too many hikes going forward.

Here’s the state of play. Back in April, the bank was looking for a small growth rebound and for oil prices to temporarily drive inflation up—but leave it within the tolerance band. The governing council said its outlook was “highly conditional” on two things: US tariffs remaining unchanged, and oil prices falling. Specifically, the Brent crude price they assumed was \$90 per barrel in the second quarter and \$75 by next summer.

Markets are pricing too many hikes.

BANK OF CANADA OVERNIGHT RATE, %



Source: Bank of Canada, TMX, Sibley Creek calculations.

The forward guidance was effectively, if our forecasts are right, we might not change the policy rate, but if we do, it’ll be a small adjustment. If Canada gets hit with more tariffs, we might cut, and if oil prices stay high, we might do “consecutive” hikes. In other words, the bank might do anything; it doesn’t know its next move. The language they used was neutral-tilting-hawkish—“consecutive” being the signpost of any directional tilt.

It's clear that the bank is acutely aware of their last mistake—namely, waiting a year too long to hike rates in the post-pandemic inflation wave. There's been a fundamental framework shift inside the institution. Sharon Kozicki, a deputy governor, gave a speech in March about how to distinguish supply shocks that warrant rate hikes from the shocks that don't. It's significant because the default instinct in central banking circles was to wait out supply shocks instead of responding.

Latest news flow tilts dovish, but not enough to move the needle.

Since the last meeting, we'd argue that the data and news flow have tilted slightly dovish, but not enough to force the bank out of "wait-and-see" mode. Inflation rose to 2.8% in April on higher gas prices, but core-trim, core-median, and the breadth of inflation all fell. Hiring improved in May, though we're still likely in the "low-hire, low-fire" environment the bank has pointed to. Labour demand looks unchanged—the volume of online job postings has held steady for a year and a half.

The two biggest developments were the latest GDP data that sparked a torrent of commentary about whether Canada's in a recession or not, and a new round of tariffs imposed by the US. Taken at face value, a recession and new tariffs would be the exact sort of thing that should make the bank start cutting rates again, which is why the news tilts dovish overall. But the headline is worse than the story.

We've already issued [two reports](#) explaining why the word "recession" overstates the weakness in the Canadian economy. Carolyn Rogers, the bank's number two, acknowledged that by one definition it's true that Canada is in a recession, but also warned that "we need to be careful not to put too much weight on any one indicator."

On the tariff front, the US said last week that it would hit Canada (and dozens of others) with a new 10% tariff, under the pretense of fighting the use of forced labour. If these were wide-ranging tariffs, they would move the needle, but CUSMA-compliant goods are exempt. That means only about a tenth of Canada's exports to the US should get hit.

The biggest wildcard, of course, is whatever is going on in the Middle East. Ceasefire or not, the crucial part for Canada is that tanker flow through the strait of Hormuz has remained close to nil since war broke out in late February and still shows no signs of improvement. Oil prices have retreated somewhat, with Brent sitting at \$94 per barrel at the time of writing. With the CPI data showing no broad pass-through, we've not yet crossed the "persistence" Rubicon that would warrant higher rates. Still, oil prices feeding inflation remains the top risk to monitor over the coming months.

Markets are pricing one or two too many hikes by the end of 2028.

Our view that the market is pricing too many hikes is largely premised on our proprietary estimate of the bank's internal staff forecasts for the policy rate path. We triangulate this path using the Taylor rule equation in the bank's ToTEM III white paper and its published MPR forecasts, with minimal additional assumptions and no judgment factor applied.

Our estimates indicate that the bank's staff economists project two hikes by next summer, settling at 2.75%, the midpoint of neutral. Markets currently envision one or two hikes by year-end, with a terminal rate between 3% and 3.25% by the end of 2028, according to CORRA futures data from TMX.

An important caveat to our estimate of these internal forecasts is that the bank does not mechanically follow its own forecasts. For instance, the bank's models would have told the governing council to start raising rates in 2021, when it only started doing so at the start of 2022. Their models would also have told them for months to start adjusting back toward 2.75%, which they've not done.

That said, the bank's internal estimate of terminal is likely 25 to 50 basis points below market expectations, and the governing council has intentionally kept policy more stimulative than the bank's indicators suggest. For these reasons, we think the degree of hawkishness baked into market pricing is a touch too high.

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