Market View
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Near-term BoC expectations running low on energy

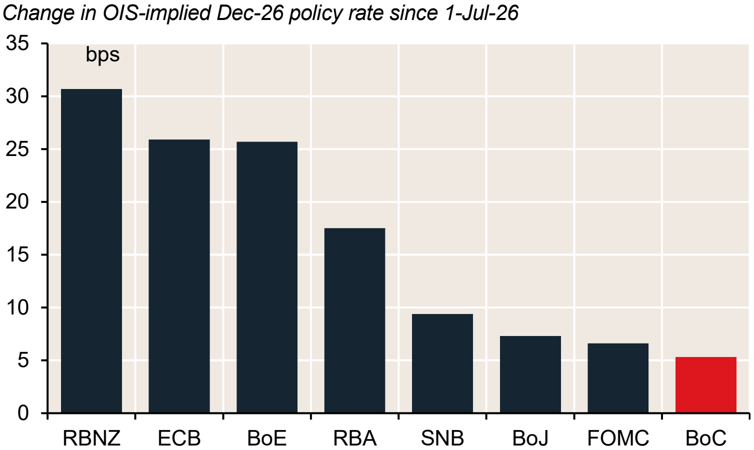
By Taylor Schleich, Vy Le & Ethan Currie

After a welcome reprieve in June, oil prices are climbing again as the war in the Middle East intensifies. The renewed energy shock has pushed rate expectations higher across most major economies as central banks come under pressure to tighten policy sooner. Canada has not been entirely immune, but the adjustment in near-term BoC pricing has been relatively modest. Since the start of July, oil prices have risen more than 30%, while the implied BoC policy rate for December 2026 has increased just 5 bps (Chart 1). In contrast, markets have added a full hike to the BoE and ECB near-term outlooks. Fed pricing has moved more like the BoC's this month, as softer employment and inflation data offset energy price pressures. But over the full course of the war, rising oil prices have had a notably larger effect on 2026 Fed expectations (admittedly, a new and seemingly more hawkish Fed Chair has played a role too, Chart 2).

A simple rolling correlation illustrates this recent dynamic (Chart 3). The relationship between oil prices and BoC policy expectations has weakened of late, while remaining strong elsewhere. This does not mean that energy prices have ceased to matter. Rather, the inflationary implications of higher oil prices have been offset by domestic developments. Recently, a somewhat dovish BoC decision, softer-than-expected inflation data and renewed tariff threats (**link**) have all restrained expectations for near-term tightening. But while investors still expect the BoC to remain on hold in the near term—at least through October—rate hikes have not been removed from the market's outlook altogether. Instead, they've largely been pushed into 2027. Indeed, if market pricing proves accurate, the BoC could deliver more tightening than any other central bank in our advanced economy sample next year (Chart 4).

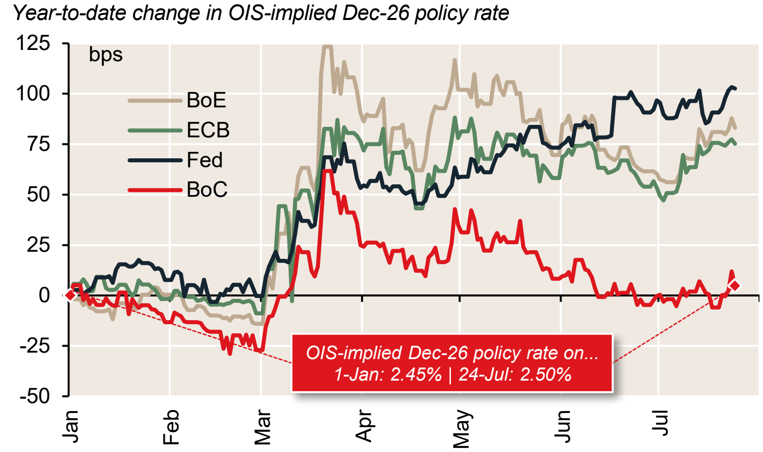
We're not convinced that the BoC will need to take its policy rate to the upper end of the neutral band (2.25% to 3.25%) as markets are implying. We nevertheless expect the Bank to begin tightening in Q1 next year as economic slack is absorbed. That's clearly later than the market-implied path, which is nearly fully priced for a December move, but earlier than the median private sector consensus which doesn't involve tightening until Q3:27. See our latest ***Fixed Income Monitor*** for more.

Chart 1: 2nd oil wave having a small impact on BoC pricing...
Change in OIS-implied Dec-26 policy rate since 1-Jul-26



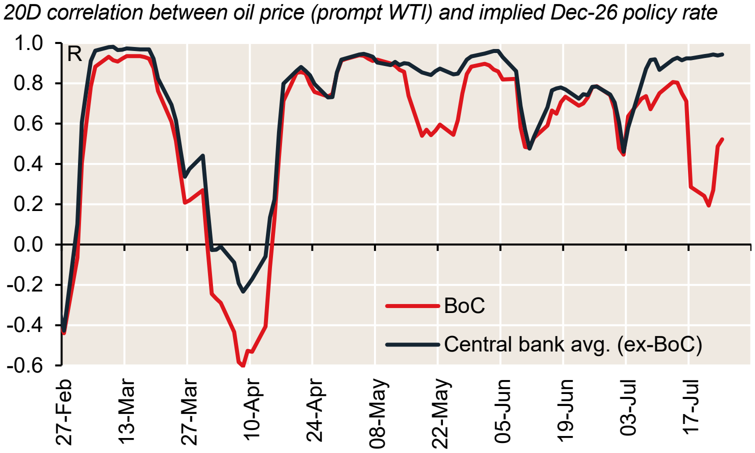
Source: NBC, BBG (WIRP)

Chart 2: …and BoC among the least affected by entire war
Year-to-date change in OIS-implied Dec-26 policy rate



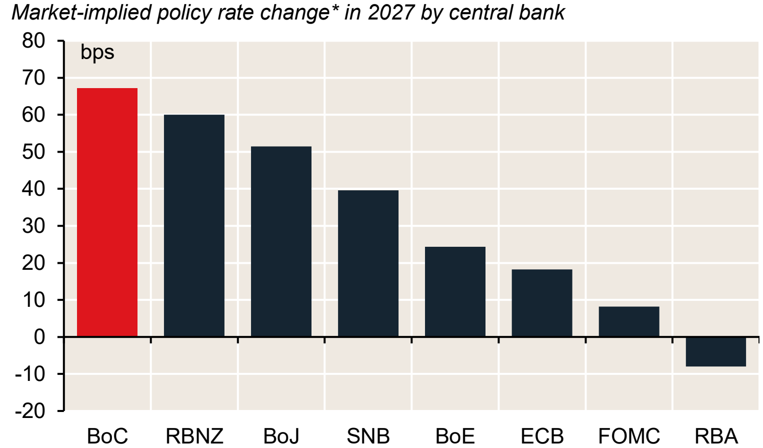
Source: NBC, BBG (WIRP)

Chart 3: Oil prices having less sway on 2026 BoC pricing…
20D correlation between oil price (prompt WTI) and implied Dec-26 policy rate



Source: NBC, BBG | Note: CB avg includes Fed, ECB, BoE, RBA, RBNZ, SNB & BoJ.

Chart 4: …as markets push hikes into 2027
Market-implied policy rate change in 2027 by central bank*



*Source: NBC, BBG | *Difference in OIS-implied Dec-26 policy rate and Dec-27 risk-free rate future (e.g., CORZ7). For AUS, NZL, the chg. in Dec-26 and Dec-27 90-day bill future is used.*

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