

October 14, 2026

Tightening Tendencies I: Anatomy of a hiking cycle

By Taylor Schleich, Warren Lovely & Ethan Currie

The exact timing of the next Bank of Canada tightening cycle is subject to no shortage of debate. Up until a few weeks ago, markets were ready for hikes to begin this month. Now, December is deemed the more likely start time. When it comes to forecasters, there are some—us included—who see the Bank's first hike being delivered this year, while others see policymakers delaying until 2027 or later. But most will concede that the direction of the overnight target is pointed up. In addition to gauging hike timing, there's still plenty of uncertainty about *how much* tightening is needed. Markets think a restrictive policy stance (relative to the Bank's estimated neutral range) is likely, while most forecasters see the BoC terminating at a lower level.

To add some perspective to these debates, we have compiled a special *In Focus* report, broken into three distinct parts. The first, contained here, investigates what Bank of Canada tightening cycles have historically involved, including the magnitude, pacing and duration of past cycles. We seek to identify historical tendencies that can be used to gauge this coming campaign and understand the reliability of market signals before and during each episode. Across three pages and eleven charts, we identify the following key takeaways:

- First, no two cycles are created equal, occurring with varying economic, inflation and financial market backdrops. Like in 2022, this

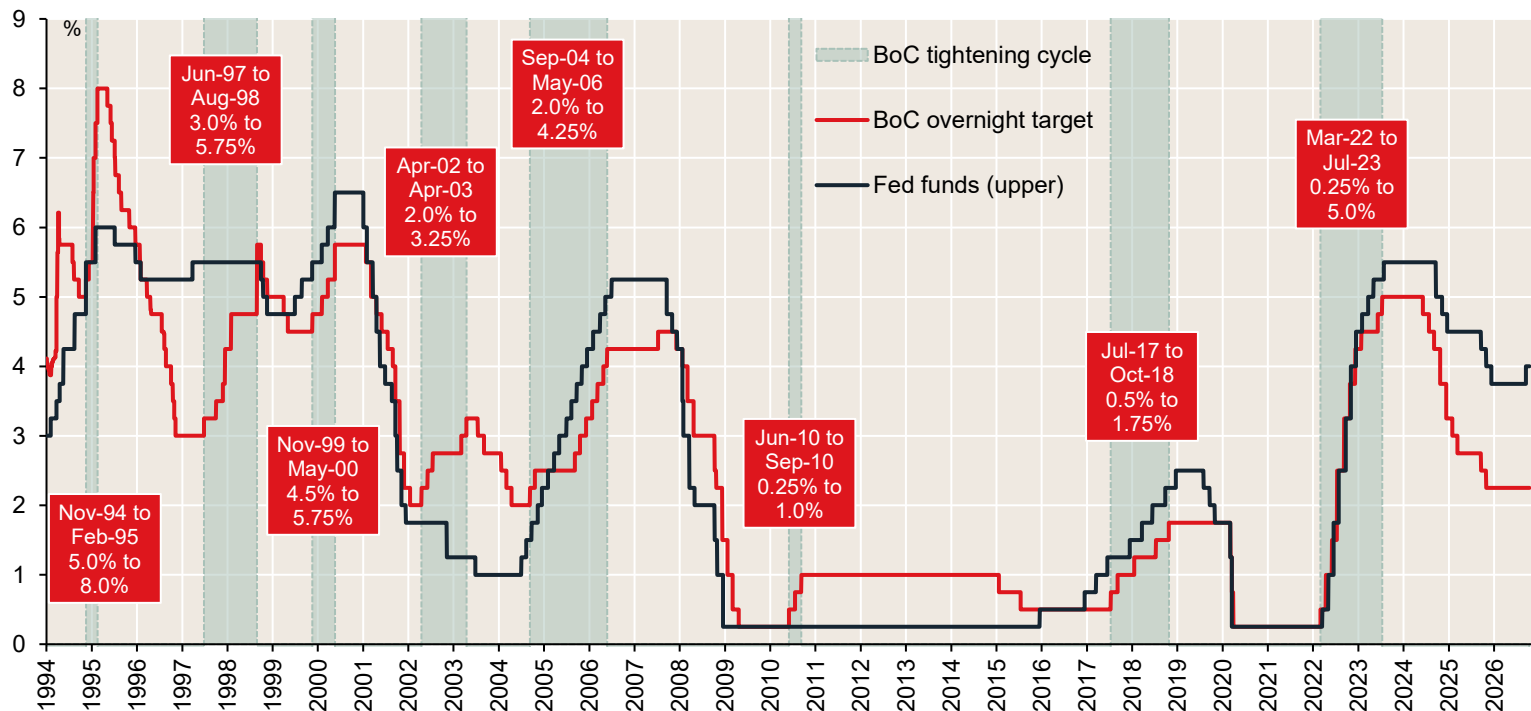
cycle will take place amidst an oil supply shock. But unlike the last episode, rates today are higher, aggregate demand is weaker, and protectionism is weighing on the economy.

- Seldom does a cycle begin with policy this close to neutral. The last time it did (1999), the Bank delivered just four hikes over six months.
- The Bank doesn't always hike into restrictive territory, with just three of the last seven cycles terminating above neutral. When policy *has* become restrictive, peak rates haven't lasted more than a year.
- Markets have a mixed record projecting the magnitude of hiking cycles. Sometimes expectations are too aggressive and sometimes expectations aren't aggressive enough (see: 2022-23). Markets are *reasonably* good at knowing when the cycle is over but do tend to maintain a slight tightening bias even after the last hike is delivered.
- One clear commonality: The Bank likes to start with back-to-back hikes, each cycle in the fixed announcement date era beginning as such. Three-in-a-row isn't uncommon either, but this isn't an ironclad tendency and unlikely to be repeated, in our view.

Note: Part II of our Tightening Tendencies series will focus on the economic context of past cycles, and the impact that rate hikes have had on the real economy. Part III will contain an analysis of financial market performance before, during and after each rate hiking campaign.

Chart 1: Over thirty years of overnight rate targeting in North America, keying on BoC tightening cycles

Bank of Canada overnight rate target and Federal Reserve fed funds target (upper), identifying distinct BoC monetary tightening cycles



Source: NBC, BoC, FRB, BBG, StatCan | Note: See Table to on page 2 for additional details on each BoC tightening cycle.

The current overnight rate targeting regime began in 1994 which produces a sample of eight historical tightening cycles. We see the first as less representative given it was engineered to shore up a cratering loonie. Thus, our analysis keys in on the last seven. There's also some subjectivity involved in 'cycle dating': A one-off hike in 2007 could be deemed part of the 2004-06 cycle but we've opted to exclude this from our analysis. Over the last 30 years, you'll find more distinct hiking episodes from the BoC than the Fed, which has just 5 unique historical cycles (not including the one underway). And if you're seeking an episode where: (a) both the BoC and Fed were hiking and (b) the BoC hiked more, you won't find one. Today, the BoC's rate is lower, suggesting that trend could be bucked. However, we see the central banks hiking one-for-one from their end-of-2025 levels. That means the large negative policy rate differential will extend into its fifth year (and well beyond).

**Table 1: No two tightening cycles have been the same, though some tendencies emerge**

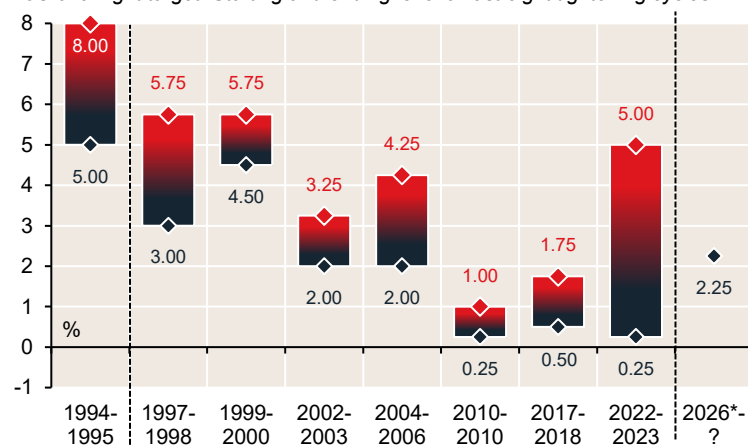
Detailed characteristics of Bank of Canada monetary policy tightening cycles, including relative U.S. Federal Reserve stance during cycle: Since 1995

BoC	BoC	Dating		Length		O/N target		Change in overnight target, initial sequencing & total hikes								Fed during BoC cycle			
Governor	Cycle	Start	End	Days	Months	Start	End	Chg.	Pace	1st hike	Delay	2nd hike	Delay	3rd hike	Hikes	Non-25	Hiking	Steady	Easing
Name	Id	Day	Day	#	#	%	%	bps	bps/month	bps	Days	bps	Days	bps	#	#	% of days	% of days	% of days
Thiessen	BOCT0	16-Nov-94	16-Feb-95	92	3.0	5.00	8.00	300	99	25	22	25	33	50	7	5	84%	16%	0%
Thiessen	BOCT1	26-Jun-97	27-Aug-98	427	14.0	3.00	5.75	275	20	25	97	25	55	25	6	3	0%	100%	0%
Thiessen	BOCT2	17-Nov-99	17-May-00	182	6.0	4.50	5.75	125	21	25	78	25	48	25	4	1	99%	1%	0%
Dodge	BOCT3	16-Apr-02	15-Apr-03	364	12.0	2.00	3.25	125	10	25	49	25	42	25	5	0	0%	0%	100%
Dodge	BOCT4	8-Sep-04	24-May-06	623	20.5	2.00	4.25	225	11	25	41	25	323	25	9	0	100%	0%	0%
Carney	BOCT5	1-Jun-10	8-Sep-10	99	3.3	0.25	1.00	75	23	25	49	25	50	25	3	0	0%	100%	0%
Poloz	BOCT6	12-Jul-17	24-Oct-18	469	15.4	0.50	1.75	125	8	25	56	25	133	25	5	0	100%	0%	0%
Macklem	BOCT7	2-Mar-22	12-Jul-23	497	16.3	0.25	5.00	475	29	25	42	50	49	50	10	6	97%	3%	0%
	AVG	Avg of last 7 cycles		380	12.5	1.79	3.82	203.6	17.4	25.0	58.9	28.6	100.0	28.6	6.0	1.4	60%	27%	13%

Source: NBC, BoC, FRB, BBG | Note: BOCT0 excluded from cycle average.

Chart 2: Recent cycles started near zero—not this time

BoC overnight target: Starting and ending level of last eight tightening cycles

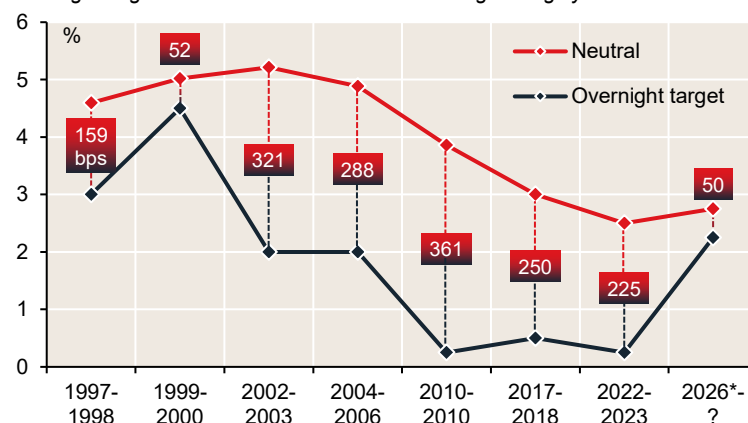


Source: NBC, BoC, BBG | Note: NBC assumes (& market implies) first hike will occur in 2026

Table 1 offers plenty of detail on past hiking cycles, including a notional 'average' cycle. But don't be fooled—no two cycles are the same, occurring with varying economic, inflation and financial market backdrops. The last few cycles started with rates near zero, but the upcoming one will buck that trend: A 2.25% policy rate is the highest to start a campaign since 1999. On average, cycles last just over a year but in our sample, cycle durations range from 3 to 20 months. Last cycle, there were many large (>25 bps) hikes, but these had become rare with none between 2001 and 2021.

Chart 4: This cycle to start near the BoC's neutral estimate...

Overnight target and neutral rate* at start of each tightening cycle

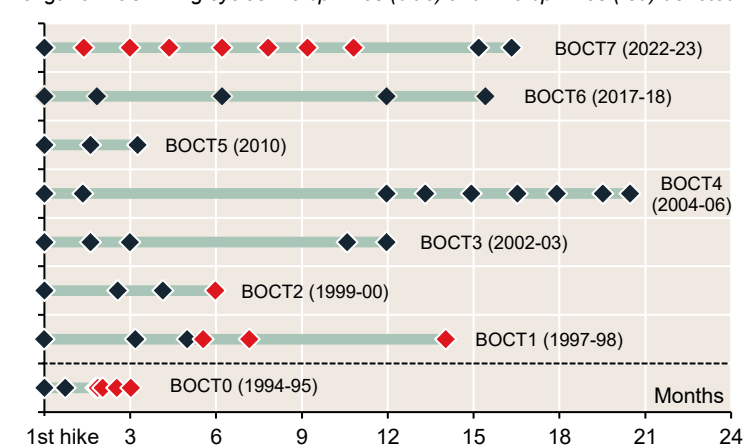


Source: NBC, BoC, NY Fed, BBG | Note: *NY Fed estimate (pre-2014); BoC estimate (2014-2026). NBC assumes (and market implies) first rate hike will occur in 2026.

It's rare to see a cycle begin with policy this close to neutral, though we'll concede that r-star estimates are imperfect. This implies there's less room to tighten than in past cycles. Still, markets see the Bank needing to venture into restrictive territory. This would hardly be unprecedented with 3 of the last 7 cycles terminating at an above-neutral policy rate. But we don't think that's likely. Instead, we see a 3% policy rate as sufficient. While that's 25 bps above the Bank's current neutral estimate, it reflects our judgement that neutral rates are moving up—in Canada and globally.

Chart 3: On average, tightening cycles last just over a year

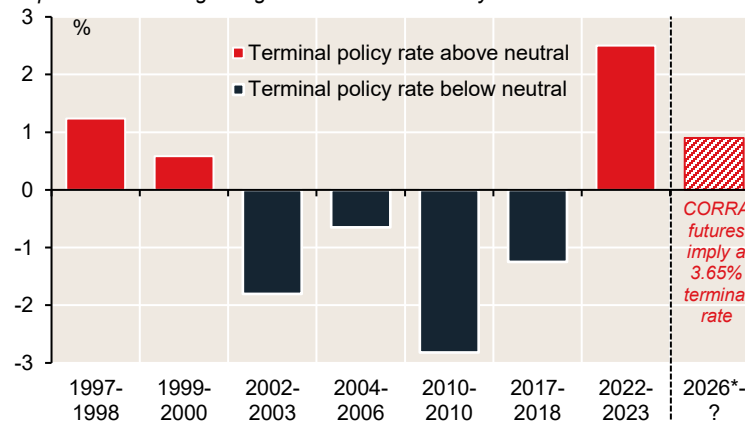
Length of BoC hiking cycles: 25 bp hikes (blue) and >25 bp hikes (red) denoted



Source: NBC, BoC, BBG | Note: Length of green line represents length of cycle

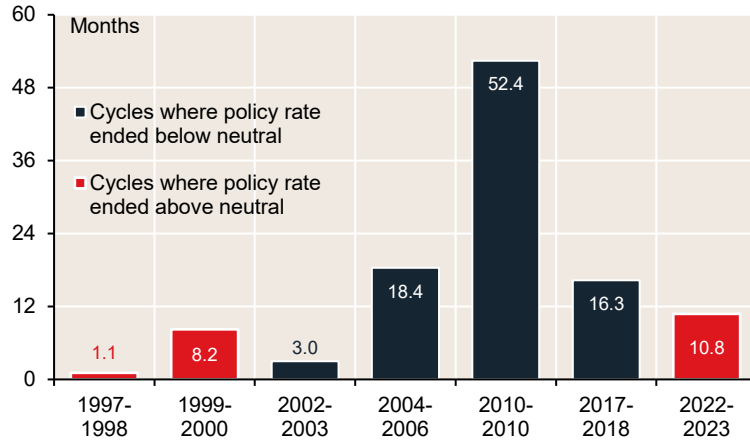
Chart 5: ...with policy seen moving into restrictive territory

Gap between overnight target at last hike of each cycle and neutral rate*



Source: NBC, BoC, NY Fed, BBG | Note: *NY Fed estimate (pre-2014); BoC estimate (2014-2026). NBC assumes (and market implies) first rate hike will occur in 2026.

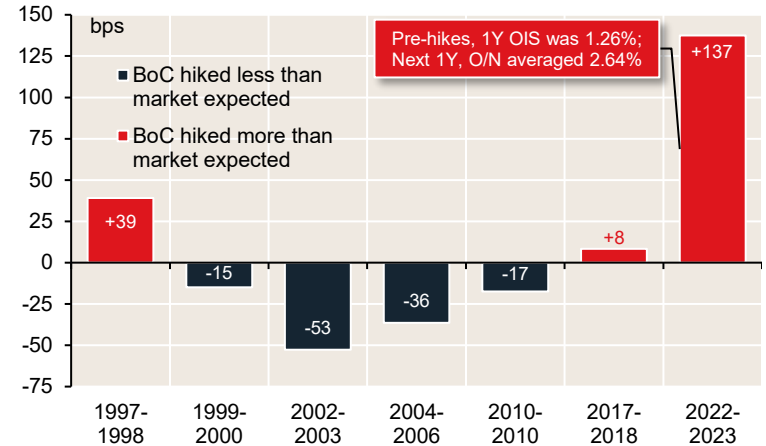
Chart 6: If restrictive, peak policy rate lasts less than a year
Length of time (in months) between last hike of cycle and first subsequent cut



Source: NBC, BBG

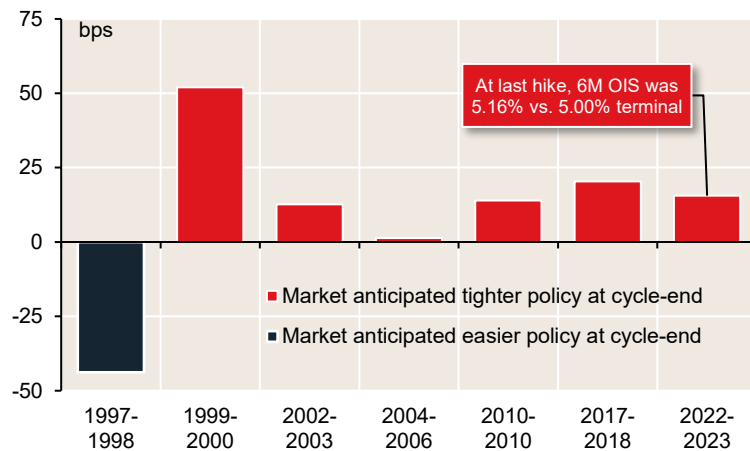
What happens when the BoC gets restrictive? The terminal rate doesn't last long, cuts coming in less than a year. Intuitively, sub-neutral rates hold longer. When it comes to gauging the magnitude of hiking cycles, the market's record is mixed. In 2022, investors vastly underestimated the degree of tightening. But in 2002 and 2004, the BoC failed to deliver on more hawkish market expectations.

Chart 7: Can market gauge hike magnitude? Results mixed.
Average overnight target in year after 1st hike less 1Y OIS* before 1st hike



Source: NBC, BBG | Note: *If OIS data is unavailable, 1Y T-bill yield used as proxy.

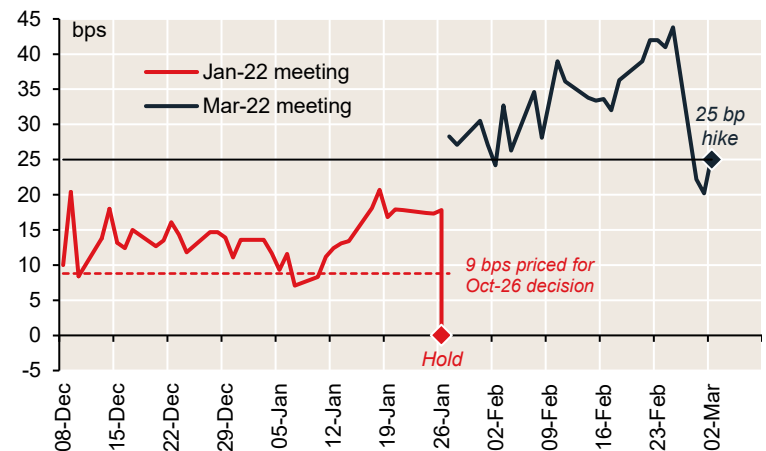
Chart 8: Does the market know when cycle is over? Kinda.
6-month OIS* rate at last hike less terminal rate of cycle



Source: NBC, BBG | Note: *If OIS data is unavailable, 6M T-bill yield used as proxy.

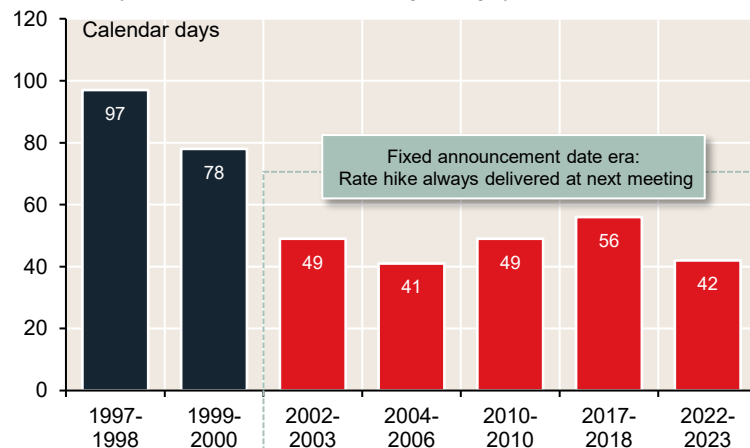
Markets have a decent sense of when the cycle is done but often price some risk of further hikes. But now we're looking too far ahead. It's still unclear when this cycle will start. Some argue the BoC will take the 'free option' and hike in October, but recent precedent leans toward December. In 2022, markets were ready for a Jan hike, but Tiff instead used the meeting to 'tee up' March. Déjà vu?

Chart 9: In early 2022, Tiff didn't take market's 'free option'
Tightening implied by OIS markets before Jan-22 and Mar-22 decisions



Source: NBC, BBG

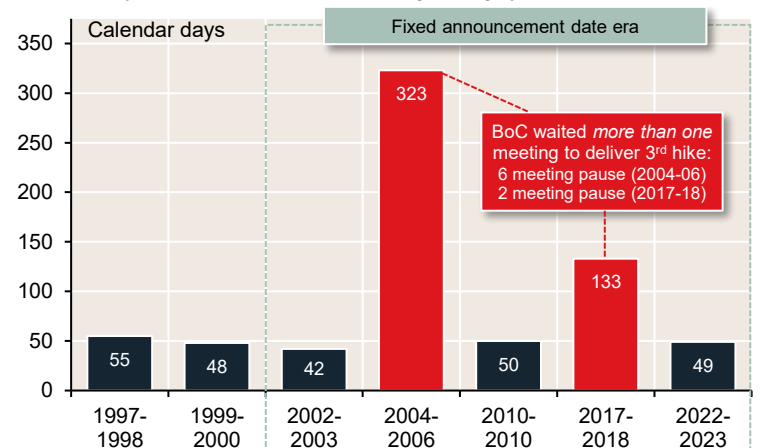
Chart 10: The BoC tends to start with back-to-back-hikes...
Calendar days between 1st and 2nd hike of tightening cycle



Source: NBC, BBG

If there's one consistent finding between hiking cycles (especially recent ones), it's that when the BoC hikes once, they hike again quickly. Each cycle in the fixed meeting date era (since 2000) has begun with back-to-back moves. And in over half of these cycles, they made it three-in-a-row. We'd fade the latter tendency this time. Two hikes and a brief pause make up our base case view.

Chart 11: ...and sometimes goes three-in-a-row
Calendar days between 2nd and 3rd hike of tightening cycle



Source: NBC, BBG



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