Economics | Current Economic Trends

Bank of Canada Rate Announcement

July 14 2021

central 1 Economics

Bank of Canada holds the line on rates, reduces QE

The Bank of Canada's latest rate announcement and Monetary Policy Report (MPR) held few surprises. As expected, the Bank of Canada maintained the target for the overnight rate unchanged today at ¼ per cent and tapered its quantitative easing (QE) program by $1 billion per week to $2 billion, reflecting improvements in the macro- economic environment and less need for stimulus.

The Bank's statement and accompanying MPR referenced a strong external economic backdrop with global growth pegged at 6.9 per cent this year, with moderating but still strong growth over the next two years of 4.4 and 3.2 per cent. While Canada's GDP growth forecast was reduced for 2021 to 6.0 per cent from 6.5 per cent in April, due to weaker than expected early- year performance, stronger activity is forecast for the second half with 2022 and 2023 growth revised higher to 4.6 per cent and 3.3 per cent forecast. Vaccinations and re-opening of economies are boosting growth. GDP levels in 2023 are higher than expected in the April MPR. Growth rotates to services, spending of excess savings, and improved exports and investments boosted by global growth and firm commodity prices.

That said, the Bank still sees ongoing slack in the economy, with employment rates below pre-pandemic levels and hours worked still down four per cent. Sector performance has varied, with low- wage workers still experiencing the slowest recovery. Indeed, the Bank emphasized that and "inclusive recovery" will take time. The output gap in the economy is estimated at -3.0 to -2.0 per cent pointing to quite a bit more runway to go before the Bank looks to raise rates. Potential GDP growth is 1.8 per cent.

This slack seems is overshadowing risks from the recent up in CPI inflation. The Bank's outlook continues suggest transitory inflation reflecting base year effects of declining prices early in the pandemic, gasoline prices, and supply constraints. Release of pent up demand has lifted prices. The Bank noted that while its measures of core inflation has increased, CPI-common (its preferred measures) is still below two per cent. Inflation expectations remain well-anchored in the long- term. The Bank sees CPI inflation of 3 per cent continuing through the back half of 2022 before trending toward two per cent in 2022 before firming again in 2023. Year-over-year growth in CPI is expected to slow to 2.0 per cent in Q4 2022. Annual CPI inflation averages 3.0 per cent in 2021, 2.4 per cent in 2022 and 2.2 per cent in 2023 which is substantially higher than the April report. That said, still within the target range of 1- 3 per cent.

The Bank re-iterated its commitment to hold the overnight rate at the current rate until economic slack is absorbed and two per cent inflation is sustainably achieved, which it deems to occur during the second half of 2022. That said, there is plenty of uncertainty given evolving potential economic output. It is also worth noting an emphasis on unevenness of the recovery and references in the accompanying Monetary Policy Report to inclusive growth suggesting the economic recovery will assessed through depth and breadth of recovery.

A number of risks to inflation persist and noted. The key negative risk is COVID-19 and effect of variants on the global and domestic economy, weaker export environment and a sharper than expected decline in Canadian housing. On the upside, household spending could outperform due to accumulated savings which would boost growth and inflation more, while supply constraints could further lift prices.

Bryan Yu
Chief Economist
byu@central1.com / P 604.742.5346
Mobile: 604.649.7209

Terms

Published by the Economics Department of Central 1 Credit Union, 1441 Creekside Drive, Vancouver, B.C. V6J 4S7

This report may have forward-looking statements about the future economic growth. These statements are subject to risk and uncertainty. Actual results may differ due to a variety of factors, including regulatory or legislative developments, competition, technological change, global capital market activity and general economic conditions in Canada, North America or internationally. This list is not exhaustive of the factors that may affect any of the this report's forward-looking statements. These and other factors should be considered carefully and readers should not place undue reliance on this report's forward-looking statements.

This report and Central 1 Credit Union disclaims any and all warranties, whether express or implied, including (without limitation) any implied warranties of merchantability or fitness for a particular purpose. This report and Central 1 Credit Union will not accept any responsibility for the reader's use of the data and/or opinions presented in this report or any loss arising therefrom.

Chief Economist: **Bryan Yu** Business Economist: **Alan Chow** Regional Economist, Ontario: **Edgard Navarrete** Economic Reseach Associate: **Ivy Ruan**