



# Bank of Canada Rate Announcement

July 13 2022

## Bank of Canada delivers super-sized hike

The Bank of Canada delivered a super-sized hike today, lifting the policy rate by 100 basis points to 2.5 per cent. This compared to market expectations for a 75-basis point increase. This was the single largest hike since 1998 and triggered by excessive inflation, which hit 7.7 per cent in May and expected to reach 8 per cent in the coming quarter, and problematic signs of higher inflation expectations. While more hikes were communicated, the Bank noted it is front loading hikes to lower rate expectations, support a soft-landing for the economy, and guard against hiking even more aggressively going in the future.

The Bank's statement highlighted ongoing inflationary pressures driven by supply chain factors, the war in Ukraine, and COVID shutdown in China, but emphasized that pressures are more widespread among goods and services. The latter risks more entrenched inflation expectations which are more difficult to curtail.

Meanwhile, it deems the economy firmly in excess demand highlighted by tight labour markets, historically low unemployment rates and rising wage pressures. Investment is being lifted by commodity prices while consumer demand is supported by services-oriented growth. That said, it expects economic growth to slow broadly into 2023 as tighter monetary policy eases growth. CPI inflation is set to remain high but slow as supply chains ease and domestic demand is rebalanced due to higher rates. This is the proverbial soft landing for the economy as it whittles away excess demand, while high job vacancies could temper risks of overall job losses.

**Today's hike is not the end. The Bank has signaled more to come, and Governor Macklem reiterated that the rate is likely to hit the top end of the neutral rate or slightly above.** With the neutral rate at an estimated 2.0 – 3.0 per cent, this implies 50 – 75 basis points of hikes through the end of the year to 3.00 - 3.25 per cent. The impacts will be swift, and housing markets already slowing will likely deteriorate faster while highly indebted households will also feel the pinch.

### *Monetary Policy Report highlights*

- The Bank also released its latest Monetary Policy Report that summarizes its key economic projections underlying the rate decision.
- Global growth expectations were reduced due to the combination of the war in Ukraine and impacts on commodity prices, inflation and more aggressive interest rate policies. Forecast output was pared by 0.2 pp to 3.3 per cent for 2022, 0.5 pp to 2 per cent in 2023 and 0.2 pp to 3 per cent in 2024. Energy prices remain volatile but remain elevated and uncertainty persists given the war in Ukraine, potential for further sanctions, or production reductions. Broader commodity prices have eased with housing slowdown and global growth deceleration.
- U.S. growth is forecast to decelerate to 1.9 per cent this year, 1.1 per cent in 2023 and 1.1 per cent in 2024. While the labour market is tight, higher interest rates are expected to curtail growth sharply. Meanwhile, the European economy is forecast to slow to 1 per cent next year before bouncing higher in 2024.
- Canadian economic growth prospects are projected to slow but compare favourably to the U.S. and other peers. Growth is forecast at 3.5 per cent this year, 1.8 per cent in 2023 and 2.4 per cent in 2022. This is a considerable reduction from the previous forecast which pegged growth this year at 4.2 per cent and 3.2 per cent. Inflation pressures and higher interest rates are feeding into a growth slowdown, particularly in the housing market, which has ancillary impacts on consumption. International trade remains firm. Over the near-term, the Bank pegs annualized growth at 4 per cent for Q2 and 2 per cent for Q3

- Average annual CPI inflation reaches 7.2 per cent this year and 4.6 per cent next, before easing to 2.3 per cent in 2024. While global factors remain a huge driver, domestic demand and re-opening trends are contributing to large increases in service prices and shelter costs. The Bank noted that three quarters of categories are growing at three per cent or more, while more than half are at 5 per cent or more. These trends are factoring into higher expectations. Over the coming quarters, y/y change in CPI is forecast to peak at 8 per cent in Q3 and come in at 7.5 per cent in Q4 before moderating to 3.2 per cent in Q4 2023 and 2 per cent by Q4 2024.
- While challenges are ahead, excess demand persists. The Bank highlighted elevated job vacancies and survey driven signs of capacity constraints. The output gap is about 0.5 – 1.5 per cent above potential, underscoring the need to slow activity. This gap is expected to close in 2023, with some excess supply in 2024 as global supply constraints ease, population rises and demand moderates.

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