



Bank of Canada Rate Announcement

October 26 2022

Bank of Canada slows its sprint, hikes 50 basis points to 3.75 per cent

The Bank of Canada slowed the pace of rate hikes with a 50- basis point increase to the target overnight rate today. Market consensus was for a larger 75- basis point increase, but the hike aligned with Central 1's forecast. This lifted the policy rate to 3.75 per cent heading into another meeting by year end. Quantitative tightening continues.

In its policy statement, the Bank noted that the economy continues to operate in a state of excess demand and tight labor markets, contributing to rising domestic inflation. Services prices continue to be driven by labour shortage and high demand.

At the same time, the slowing global growth profile seems to have curbed the appetite for a larger increase, as the Bank noted slowing activity, particularly in the U.S. and the euro area. In the latter, the Bank forecasts no growth through much of 2023 and contraction in the euro area in coming quarters. This slowdown is already seeping through export channels.

Moreover, the Canadian economy is adjusting to prior policy rate adjustments with a retreat in housing, while consumer and business spending is slowing. These factors are anticipated to slow the economy through the first half of 2023.

Nevertheless, the statement points to further hikes as inflation remains strong. As noted, "price pressures remain broadly based, with two-thirds of CPI components increasing more than 5% over the past year. The Bank's preferred measures of core inflation are not yet showing meaningful evidence that underlying price pressures are easing." Inflation is expected to move down to about 3 per cent by end of 2023 (compared to 6.9 per cent at last print) with a return to target by the end of 2024. The risks of entrenched higher inflation expectations persist.

In a nod to more tightening, the Bank stated that, "Given elevated inflation and inflation expectations, as well as ongoing demand pressures in the economy, the Governing Council expects that the policy interest rate will need to rise further." That said, we expect that an end to this tightening cycle is near, supported by and Bank alluded to data dependence being more important in assessing future hikes.

We anticipate another hike of up to 50- basis points at the December meeting before a pause through 2024.

Monetary Policy Report

Alongside the statement the Bank of Canada released the latest Monetary Policy Report which outlined its views for the economy. Key highlights included:

- Global economic growth is revised lower to 1.6 per cent next year (from 2.0 per cent) and 2.6 per cent in 2024 (from 3.0 per cent). This marks the slowest pace since 1982. U.S. economic growth is forecast to slump to 2.0 per cent in 2023 and remain low at 1.1 per cent in 2023 driver by higher interest rates, while euro area contracts and China begins to recover. This will impact Canadian exports. Slowing global growth tempers inflation.
- Canada economic growth is revised lower to 0.9 per cent in 2023 (downward revised from 1.8 per cent) and 2.0 per cent in 2024 (from 2.4 per cent). Domestic financial conditions have tightened up owing to higher domestic and international interest rates. Housing has slowed, while spending on goods and investment is expected to soften. Quarterly growth is expected to be between 0 and 0.5 per cent in the latter half of 2022 and into 2023, suggesting no recession expectation at this point. Growth is forecast to improve in the second half of 2023.

- Potential output in the economy was revised lower, reflecting persistent supply chain and lower permanent productivity and labour market mismatch. In contrast net migration is a partial offset. Lower potential output contributes to weaker economic growth as well capacity in the economy.
- On excess demand in the economy, conditions remain tight and reflected in a low unemployment rate and survey responses that point to ongoing labour shortages. The output gap in the economy is estimated at 0.25 per cent to 1.25 per cent, which was consistent with the second quarter.
- The Bank's assessment of inflation is for a 6.9 per cent annual rate this year which falls to 4.1 per cent in 2023 and 2.2 per cent in 2024. Trend inflation remains excessive despite slowing in recent months. Year-over-year inflation in Q4 2023 is forecast to come in at 2.8 per cent and fall to 2.0 per cent by Q4 2023.

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Terms

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