Bank of Canada Rate Announcement

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Economics

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Bank of Canada holds at 4.5%, conditional pause has upside risk

The Bank of Canada upheld its conditional rate pause today, maintaining its policy rate at 4.5 per cent while continuing its quantitative tightening path. This was largely expected given the Bank had only committed to a pause in January meeting and Canadian inflation trends have been constructive, despite divergent patterns south of the border. The Bank reiterated its expectations that inflation will decline to 3 per cent by mid-2023. While year-over-year and short-term inflation trends are heading in the right direction, further inflation deceleration is needed. There remains an upside risk to the policy rate, which depends on how inflation and the economy evolves.

There were few surprises in the announcement which summarized global and domestic developments. Broadly global growth is decelerating, and inflation has eased on energy prices, but short-term growth and inflation outlooks are stronger than expected in the U.S. and Europe, while upside risk to commodity prices has emerged from China's re-opening, while U.S. dollar strengthened.

Domestically, the Bank highlighted the soft Q4 GDP data which was driven by a sharp pullback in inventory investment, while some components of domestic demand continued to expand including consumption, government, while net exports gained. Despite this, household spending is slowing, and business investment has weakened amidst higher rates and slower foreign demand. That said, labour market remains tight with wage pressure in the 4-5 per cent range.

Today's announcement was relatively neutral in maintaining its pause but showed some upward bias towards tightening if needed. It will be watching the path of inflation closely and prospects of import price inflation if tightening accelerates south of the border. Economic developments will determine a next hike – or not.

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