



April 12 2023

## Bank of Canada holds steady as global economic uncertainty rises

There was no surprise today as the Bank of Canada held the line on its policy interest rate, keeping the target for the interest rate at 4.5 per cent while maintaining its path of quantitative tightening.

The Bank's statement highlighted the evolution and divergence of patterns in the broader economy. This included declining global inflation trends and stronger growth profiles early this year in areas like the U.S. At the same time, banking stress (highlighted by the collapse of SVB and Credit Suisse), will be an expected drag on growth due to tighter credit conditions going forward.

In Canada, the Bank expects growth to slow through the remainder of this year due to the impacts of past monetary policy tightening and softer foreign demand. It pegs growth at 1.4 per cent this year (higher than its prior estimate) and 1.3 per cent next year. This softening contributes to excess supply in the economy during the second half, which could signal some openness to rate reduction later this year but that is still doubtful in our view.

The Bank reiterated its expectation that headline inflation declines to about three per cent by mid-year but anticipates a more challenging time to get to a 2 per cent rate, which is anticipated by late-2024. Services-price inflation and wage growth remain elevated, and the Bank also cited corporate pricing suggesting the Bank sees high margins as a reason for excess inflation.

The Bank is still biased on the upside for the policy rate but there is little to suggest a near-term change in conditions. It noted that, "Governing Council continues to assess whether monetary policy is sufficiently restrictive to relieve price pressures and remains prepared to raise the policy rate further if needed to return inflation to the 2% target." We still expect the Bank to hold through 2023 at 4.5 per cent.

The release of the accompanying Monetary Policy Report provided a detailed overview of the Bank's outlook that drove the rate decision. Highlights of the report include:

- Global growth revised higher for 2023 to 2.6 per cent (compared to 1.9 per cent in the prior report) but masks a sharper deterioration in the back half of the year due to U.S. and Europe banking stress which constrains growth through credit markets. Growth slows to 2.1 per cent in 2024 which was revised lower, but a rebound in 2025 to 2.8 per cent is forecast. Inflationary pressures remain elevated globally but are declining. The speed of declines will depend on evolution of services pricing.
- U.S. economic growth was revised sharply lower in 2024 to 0.4 per cent, albeit with 2023 revised up to 1.3 per cent. Funding costs have risen following SVB, and consumers are expected to pull back on demand for goods due to higher retail rates and a lower share of income going to households.
- Canada GDP growth is revised up to 1.4 per cent for 2023 (compared to 1.0 per cent in the previous report), and slow to 1.3 per cent in 2024, and rebound in 2025 to 2.5 per cent. Housing remains a drag, while consumption growth slows with the pass through of higher interest rates and more mortgage renewals. Government spending is supportive. Slowing global conditions impact demand for Canadian goods.
- On a quarterly basis, the Bank now expects a 2.3 per cent growth rate in Q1 and 1.0 per cent in Q2 but implies no recession this year with growth averaging about 0.9 and 0.3 per cent during the third and fourth quarters.
- Inflation is declining and the Bank anticipates an average of 3.3 per cent (y/y) in Q2 and 2.5 per cent in Q4. Headline CPI does not return to 2 per cent until late in 2024 or early 2025. Inflation expectations remain high and excess demand persists, although a sharp increase in labour supply is mitigating some of the pressures of strong early year hiring. Supply is expected to moderate pressures on the economy and inflation.

- Potential GDP was reduced in the latest MPR despite a lift from population. Business investment and supply chain challenges were the main drivers. Potential GDP growth is 2.3 per cent in 2023 (down a full point from the previous estimate) and 2.1 per cent in 2024. The Bank's estimate for the neutral rate of interest was unchanged at 2-3 per cent.

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