Bank of Canada Rate Announcement

September 6 2023

central 1 Economics

Bank of Canada holds at 5.00 per cent, has it overtightened?

It is decision day for the Bank of Canada and as expected, the rapid downshift in the economy during the second quarter moved it to the sidelines in what we expect marks the peak of this interest rate cycle. The Bank maintained the target for the overnight rate unchanged at 5.00 per cent while continuing its quantitative tightening policy.

This hold was widely anticipated given recent GDP data, but the Bank's statement and assessment of the economy was decidedly more downbeat than the July decision and evidence that the last two rate hikes may have been policy missteps.

Specifically, global economic conditions are mixed with severe weakness percolating from China which is countering U.S. strength while European activity is mixed. Real interest rates have increased while oil prices are also up. Domestically, the highlight was the underperformance of the economy. As observed last week, Q2 GDP growth downshifted dramatically. The Bank emphasized the contraction of 0.2 per cent (note that its previous Monetary Policy Report pegged growth near 1.5 per cent), reflecting weaker consumption which was one of the main drivers of hawkish language in prior decisions. Credit growth is slowing pointing to pass through of interest rates. Labour markets are loosening, but the statement did note wage growth remains elevated. The Bank's assessment is there is "recent evidence that excess demand in the economy is easing."

Inflation itself took a bit of a backseat in today's statement, with the Bank noting the July upswing to 3.3 per cent, while core inflation measures also have held elevated. There is risk up near-term upside due to higher gasoline prices and risk of entrenched inflation. Nevertheless, the focus was on the surprise underperformance in the economy and lagged impacts of monetary policy. The Bank remains data dependent on inflation pattern but will be monitoring the path of excess demand, inflation, wage growth and corporate pricing. With a weak handoff in GDP to Q3 pointing to little growth and cumulative impacts of rate hikes still to come, we expect the Bank to stay on hold until Q1 2024 when it commences rate cuts. That said, expect the Bank's language to remain biased towards hikes as it guards against stoking demand and inflation.

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