



# Bank of Canada Rate Announcement

October 25 2023

## Bank's hawkish hold keeps policy rate at 5.0 per cent, inflation still sticky

As anticipated, the Bank of Canada kept to the sidelines with today's monetary policy announcement, holding the target for the overnight rate at 5.0 per cent while maintaining its quantitative easing path. However, it maintained a hawkish bias with inflation remaining higher and stickier than expected which we view as contributing to the policy rate remaining at the current level into mid-2024.

The Bank's decision to hold off on another rate hike aligns with softer patterns in recent economic data and lower than expected inflation in September. Its statement highlighted the global and domestic slowing of activity. The former has seen an overall deceleration, which is anticipated to continue, despite a shift in composition as the U.S. has proven much stronger than expected and China weakness. Inflation is broadly easing.

Domestically, the Bank emphasized the pass through of prior interest rate hikes on the economy. Specifically, it noted that consumption "has been subdued," for broad housing and durable goods, while investment demand is slowing with higher interest rates and weaker demand. Labour markets remain tight and wage growth remains. However, conditions have eased as labour force expansion, due in large part to strong population growth, has outpaced employment growth. Importantly, the narrative of excess demand (which was proven inaccurate following recent GDP revisions), has shifted as the Bank stated "Overall, a range of indicators suggest that supply and demand in the economy are now approaching balance." Indeed, one could argue that the absence of summer hikes would put us in the same position.

Nonetheless, a still hawkish tone reflects uneven inflation patterns in recent months and a slow decline in core inflation. Specifically, "Governing Council is concerned that progress towards price stability is slow and inflationary risks have increased and is prepared to raise the policy rate further if needed". That said, prior rate hikes are curbing inflation of interest sensitive goods and services, and food prices are easing. In contrast, the Bank referenced high shelter inflation, including self-inflicted pain of mortgage rates, and rent which we think is more troublesome and not easily arrested. Adding to the pressure are inflation expectations, high corporate pricing patterns and surprisingly strong wage growth. The Bank still anticipates inflation to decline to 3.5 per cent in mid-2024, and 2.0 per cent in mid-2025. Its updated quarterly projections suggest a slower decline than previously forecast.

We think today's hold was the right decision and in line with our view that this rate hike cycle has concluded, despite the hawkish tone, and some inflation risks around wages and shelter. We anticipate further cooling in the economy as rates further curb consumption, housing, and investment. While the Bank's upward forecast revision for inflation suggests a higher for longer stance, we are still of the view that the Bank could cut rates later in the second quarter.

### *The Bank issued its latest Monetary Policy Report (MPR) with today's statement. Highlights included:*

**Global economy:** Economic forecast was consistent with the July MPR but composition of growth has shifted with strength in the U.S. and weakness in other major economies. Global GDP growth for 2023 is projected at 2.9 per cent (+0.1 pp), 2024 at 2.3 per cent (-0.1 pp) and 2.6 per cent in 2025 (-0.1 pp). U.S. growth was revised higher significantly this year to 2.2 per cent (+0.4 per cent) and in 2024 to 0.8 per cent. Europe's economy stalls both this year (0.5 per cent) and next (0.7 per cent), while China growth is reduced to 5.1 per cent this year and 4.5 per cent next year. Inflation is broadly retreating around the globe as the supply chain fully heals and higher rates curb demand for non-energy goods and shelter, but higher oil prices pose a risk.

**Canada economy:** As expected, Canada's GDP forecast was sharply reduced, reflecting prior data revisions that showed a much weaker than expected early year growth. Annual GDP growth for 2023 was cut to 1.2 per cent, compared to 1.8 per cent in the July report, with a forecast 0.9 per cent in 2024 (-0.3 pp) and a steady 2.5 per cent in 2025. It is forecasting an annualized growth of 0.8 per cent for both Q3 and Q4. The slowdown reflects weaker consumption, a contraction in housing this year, and sluggish business investment. The economy is unlikely to be in a state of excess demand (which drove summer rate decisions), with the Bank estimating an output gap of -0.75 to 0.25 per cent.

**Inflation:** CPI inflation has been revised higher through the forecast period. Average annual inflation is forecast at 3.9 per cent this year (+0.2 pp), 3.0 per cent in 2024 (+0.5 pp) and 2.2 per cent in 2025. It forecasts a rate of 3.7 per cent in Q3 and 3.3 per cent in Q4 2023, with an average of about 3.5 per cent through mid-2024.

Noteworthy in the MPR was an emphasis on shelter costs, where inflation was 8 per cent over 8.0 per cent and looks to be sticky. While recognizing the impact of mortgage interest costs and impact of rates on this component, shelter is not evolving as typically expected with offsets by house-price related components. Undersupply of housing and high population is limiting the downside, which could prove sticky.

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