Bank of Canada Rate Announcement

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Economics

Bank of Canada holds policy rate as economy eases, inflation trends constructive

There were some early holiday cheers for indebted households today as the Bank of Canada gave as clear a signal as likely possible, without a definitive statement, that its policy interest rate has peaked. The Bank held its target for the overnight rate at 5.0 per cent and maintained quantitative tightening.

Its statement highlighted weakening economic and constructive inflation trends, both domestically and abroad. Globally, trends are easing, and while the U.S. economic growth data has remained robust, it is anticipated to weaken in coming months due to lagged effects of monetary policy tightening. Oil prices are declining and lower than projected and the weakening US dollar remains constructive for inflation.

Domestically, the Bank referenced the latest GDP data and the surprising magnitude of the Q3 contraction of 1.1 per cent following a 1.4 per cent (upward revised) Q2 and highlighted the impact of higher interest rates on spending. This included flat consumer spending and business investment, albeit with an uptick in housing and stronger government spending. These patterns are driving an easing labour market, with higher unemployment rate and declining job vacancy rate, and while the Bank noted that wage growth is still elevated at 4-5 per cent, it does not an economy in excess demand. We would question whether the economy was in a period of excess demand at all in the current cycle.

Importantly, the Bank is seeing the economic slowdown as a contributor to easing inflation which is down to 3.1 per cent, although shelter price growth remains higher due to rent and mortgage interest costs. Core inflation is still elevated at 3.5 – 4.0 per cent, but October is at the lower end. While not referenced in the statement, monthly annualized trends have slowed more substantially.

The combination of constructive inflation patterns and weakening drove the Bank to hold today, and while it gave a nod to potential further hikes, language was more tepid, stating “, Governing Council is still concerned about risks to the outlook for inflation and remains prepared to raise the policy rate further if needed”. The Bank noted it would look for more sustained easing of core inflation, and is focusing on broader trends in the economy, inflation expectations, wage growth and corporate pricing.

The Bank’s latest statement further solidifies our view that the next rate move will be a reduction, which may come as early as April as the economy remains subdued due to monetary policy impacts on consumers and mortgage renewals and rising unemployment rates.

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