Bank of Canada Rate Announcement

January 24 2024

Bank of Canada holds again, timing of cut remains uncertain

To no surprise, the Bank of Canada held the target for the overnight rate unchanged today at 5.00 per cent and continued quantitative tightening. However, there was as clear an indication as any that interest rate hikes are done, with no reference to any further hike in its release (albeit the presser kept the door open), and statement that the economy is currently in excess supply. The Bank is downbeat on the economy, although sticky core inflation has it cautious about timing of its first cut.

The Bank's published statement heavily focused on mixed economic conditions and expectations of future weakness. The U.S. while stronger than expected in 2023 at a forecast 2.5 per cent, is expected to slow this year to 1.7 per cent albeit better than previously anticipated. In contrast, weaker conditions are observed in the euro area and China. Domestically, the Bank highlighted a stagnant economic performance since mid-2023 which is projected to remain so through early 2024. Labour markets are cooling with job vacancies returning to pre-pandemic trends, and important to underscore again is that the Bank sees the economy "operating in modest excess supply." We had flagged that this was the case since October. There is clearly no need to hike again unless the economy heats up. The Bank projects growth of 0.8 per cent this year and 2.4 per cent in 2025.

That said, and as expected, the Bank remains cautious on the path of inflation. It noted that wage growth remains positive at 4-5 per cent. This is inconsistent with normal inflation. Inflation is running at 3.4 per cent at year-end, and "core inflation is not showing sustained declines". It is noteworthy the Bank's callout of shelter as the biggest contributor to higher than target inflation as it reflects policy rate decisions through the mortgage rate channel, while monetary policy has little influence on short-term housing supply dynamics and population growth driving rent prices. We think policy rates will need to look through impacts of shelter.

The next move is expected to be a cut, but timing remains uncertain. Tiff Macklem noted in its presser "that if the economy evolves broadly in line with the projection we published today, I expect future discussions will be about how long we maintain the policy rate at 5%". The Bank expects headline inflation to remain near 3 per cent through mid-year before declining in the back half of year, which is still likely too high for the Bank to commence a reduction. Our forecast is currently for an April cut, but a push to June is reasonable.

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

Global economy:

The global growth forecast was essentially unchanged for 2023 at 3.0 per cent compared to 2.9 per cent, with 2024 nudged up 0.2 pp to 2.5 per cent, and 2025 growth at 2.7 per cent. However, this reflected sharp upward revisions to the U.S. (2.5 per cent in 2023 vs 2.2 per cent), and 1.7 per cent in 2024 vs previous outlook of 0.8 per cent. In contrast, the euro area is weakening at 0.5 per cent in 2024 with China at 4.5 per cent. Broad deceleration in growth in 2024 owes to ongoing pass through of monetary tightening and other structural issues in a country like China. Broadly inflation continues to retreat with declines in oil prices, shift away from goods, and supply chain improvements although there remains upside risk from the Red Sea. Shelter costs remain inflationary, but likely to ease in the U.S.

Canada economy:

Canada's growth outlook was lowered a notch through the forecast period. Forecast growth in 2023 was cut to 1.0 per cent from 1.2 per cent, while 2024 and 2025 were cut 0.1 pp to 0.8 per cent and 2.4 per cent. After no growth in Q4, GDP growth is forecast to rise by 0.5 per cent in Q1 (annualized). Broadly the bank is forecasting sluggish activity across consumption, housing and business sectors. Growth is anticipated to pick up again in late 2024 through 2025. The economy now sits in a excess supply with a forecast output gap of -0.25 and -1.25 per cent. This is also observed in easing labour market conditions and lower job vacancy rates.

Inflation:

The Banks's CPI inflation is for gradual moderation. Forecast y/y inflation averages 3.2 per cent in Q1 and above 3 per cent for the first half. This gradually moves lower in the back half of the year with a forecast of 2.4 per cent in Q4 2024 and 2.1 per cent in Q4 2025.

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Terms

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