Bank of Canada Rate Announcement

central 1 Economics

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Bank of Canada holds again, but weakening Canadian economy sets stage for cut

There were no surprises this morning as the Bank of Canada held its policy rate at 5.00 per cent, which was aligned with market expectations, and continued it quantitative easing path. As expected, the Bank continued to preach patience on rate cuts citing persistence in underlying core inflation.

The Bank's statement covered the state of the global economy which is slowing outside a still robust U.S. economy, while bond yields have risen (in part due to U.S. conditions. Canadian conditions are mixed as the Bank noted the stronger than anticipated Q4 GDP performance, but importantly, it emphasized that "the pace remained weak and below potential", and domestic demand particularly investment fell sharply offset by exports. Central 1 had discussed these points in our own review of the GDP print. Moreover, with modest excess supply in the economy evident, the Bank noted that employment is growing more slowly than population, and "wage pressures may be easing." Wage growth is a key factor that needs to moderate before a rate cut.

On the inflation front, the lower-than-expected inflation print (2.9 per cent) in January was referenced, but the Bank focused on the drivers of inflation. While goods price inflation moderated, underlying pressures persist, particularly shelter. Core measures of inflation remained from 3-3.5 per cent, and the Bank expects inflation to remain close to 3 per cent in the first half before easing.

The Bank continues to preach patience, "Governing Council wants to see further and sustained easing in core inflation and continues to focus on the balance between demand and supply in the economy, inflation expectations, wage growth, and corporate pricing behaviour."

While timing will be data dependent, we expect a rate cut in June as economic patterns falter. Particularly, domestic demand is weak with declining per capita performance, and investment has retrenched sharply. There will be a temporary boost in January to GDP from the public sector which will fade, while labour market slack will likely increase. Shelter will be an ongoing challenge for inflation, but a lower policy rate would feed through mortgage interest costs, while the Bank has little influence on drivers like housing supply or immigration. We expect the Bank to "look through" shelter costs as it assesses the timing of a cut.

Bryan Yu
Chief Economist
Central 1 Credit Union
byu@central1.com