

ESSENTIALS OF MONETARY POLICY

Bank of Canada (BoC)

Bank of Canada Lives for the Pause

By Randall Bartlett, Senior Director of Canadian Economics

ACCORDING TO THE BOC

- ▶ As was widely expected, the Bank of Canada kept the overnight rate unchanged today, leaving the policy rate at 4.50%. However, the Governing Council maintained its hawkish tone in the press release, stating it “remains prepared to raise the policy rate further if needed to return inflation to the 2% target.”
- ▶ The statement made clear that “recent data is reinforcing Governing Council’s confidence that inflation will continue to decline in the next few months.” Indeed, it is projecting inflation to fall to around 3% in mid-2023 before gradually grinding lower to around the 2% by the end of next year. However, elevated inflation expectations, strong wage growth and services inflation, and atypical business pricing behaviour are expected to provide an ongoing headwind to bringing high inflation to heel.
- ▶ Digging into the details of the Monetary Policy Report (MPR), the Bank raised its forecast for Q1 2023 real GDP growth to 2.3% annualized from 0.5% in the January MPR, a smidge lower than our tracking. It has also pencilled in a 1.0% advance in Q2. As a result, the forecast for 2023 annual real GDP growth was also revised higher to 1.4%, with notable upward revisions to consumption and exports. This was offset by a meaningful downward revision to 2024, from 1.8% to 1.3%, reflecting a more delayed impact of higher interest rates. This remains more optimistic than our base case forecast for weaker real GDP growth this year and next on the back of a recession in the second half of 2023.
- ▶ In a bit of an unexpected twist, the Bank reduced its forecast for potential GDP growth in 2023 and 2024. The midpoints are 2.3% and 2.1%, respectively, down from 2.35% and 2.45% in the January MPR. With population growth in Canada through the roof, the central bank was widely expected to push potential GDP growth higher. But while trend employment looks to have been revised higher, this

was offset by a downward revision to labour productivity growth, reflecting weakness in business investment and more persistent supply chain disruptions.

- ▶ As a consequence of leaving the pace of potential GDP growth broadly unchanged, the Bank maintained the neutral rate of interest within a range of 2% and 3%. That puts the midpoint at 2.5%, assuming a real neutral rate of 0.5% when inflation returns to its 2%. This implies the house view at the Bank of Canada is that rates will return to business as usual once the lagging impacts of the pandemic are finally in the rear view, a view shared by the IMF but not necessarily by markets.

IMPLICATIONS

Today gave us the opportunity to check in to see what condition the Bank’s conditional pause is in. As expected, the Governing Council abided by its commitment to keep the policy rate on hold as long as economic indicators unfolded in line with its expectations. Of course, a lot has happened since the January MPR. But most importantly, inflation has come down faster than the Bank had previously anticipated and financial conditions have tightened on the back of banking sector turbulence outside of our borders. Together, these look to have outweighed the sustained strength in the Canadian economy and labour market, and should work to ensure the Bank’s next move is a rate cut as early as the end of the year.

2023 Schedule of Central Bank Meetings

Date	Central bank	Decision	Rate
January			
13	Bank of Korea	+25 b.p.	3.50
18	Bank of Japan	unchanged	-0.10
19	Bank of Norway	unchanged	2.75
25	Bank of Canada*	+25 b.p.	4.50
February			
1	Bank of Brazil	unchanged	13.75
1	Federal Reserve	+25 b.p.	4.75
2	European Central Bank	+50 b.p.	3.00
2	Bank of England	+50 b.p.	4.00
6	Reserve Bank of Australia	+25 b.p.	3.35
9	Bank of Sweden	+50 b.p.	3.00
9	Bank of Mexico	+50 b.p.	11.00
21	Reserve Bank of New Zealand	+50 b.p.	4.75
23	Bank of Korea	unchanged	3.50
March			
6	Reserve Bank of Australia	+25 b.p.	3.60
8	Bank of Canada	unchanged	4.50
10	Bank of Japan	unchanged	-0.10
16	European Central Bank	+50 b.p.	3.50
22	Bank of Brazil	unchanged	13.75
22	Federal Reserve	+25 b.p.	5.00
23	Bank of England	+25 b.p.	4.25
23	Bank of Norway	+25 b.p.	3.00
23	Swiss National Bank	+50 b.p.	1.50
30	Bank of Mexico	+25 b.p.	11.25
April			
4	Reserve Bank of Australia	unchanged	3.60
4	Reserve Bank of New Zealand	+50 b.p.	5.25
12	Bank of Canada*	unchanged	4.50
13	Bank of Korea	unchanged	3.50
26	Bank of Sweden		
28	Bank of Japan		
May			
2	Reserve Bank of Australia		
3	Bank of Brazil		
3	Federal Reserve		
4	European Central Bank		
4	Bank of Norway		
11	Bank of England		
18	Bank of Mexico		
23	Reserve Bank of New Zealand		
25	Bank of Korea		
June			
6	Reserve Bank of Australia		
7	Bank of Canada		
14	Federal Reserve		
15	European Central Bank		
16	Bank of Japan		
21	Bank of Brazil		
22	Bank of England		
22	Bank of Norway		
22	Bank of Mexico		
22	Swiss National Bank		
29	Bank of Sweden		

Date	Central bank	Decision	Rate
July			
4	Reserve Bank of Australia		
11	Reserve Bank of New Zealand		
12	Bank of Canada*		
13	Bank of Korea		
26	Federal Reserve		
27	European Central Bank		
28	Bank of Japan		
August			
1	Reserve Bank of Australia		
2	Bank of Brazil		
3	Bank of England		
10	Bank of Mexico		
15	Reserve Bank of New Zealand		
17	Bank of Norway		
24	Bank of Korea		
September			
5	Reserve Bank of Australia		
6	Bank of Canada		
14	European Central Bank		
20	Bank of Brazil		
20	Federal Reserve		
21	Bank of England		
21	Bank of Norway		
21	Swiss National Bank		
22	Bank of Japan		
28	Bank of Mexico		
**	Bank of Sweden		
October			
2	Reserve Bank of Australia		
3	Reserve Bank of New Zealand		
19	Bank of Korea		
25	Bank of Canada*		
26	European Central Bank		
31	Bank of Japan		
November			
1	Bank of Brazil		
1	Federal Reserve		
2	Bank of England		
2	Bank of Norway		
6	Reserve Bank of Australia		
9	Bank of Mexico		
28	Reserve Bank of New Zealand		
30	Bank of Korea		
**	Bank of Sweden		
December			
4	Reserve Bank of Australia		
6	Bank of Canada		
13	Bank of Brazil		
13	Federal Reserve		
14	European Central Bank		
14	Bank of England		
14	Bank of Norway		
14	Bank of Mexico		
14	Swiss National Bank		
19	Bank of Japan		

NOTE: Central banks may decide to change rates between the scheduled meetings. The abbreviation b.p. stands for basis points. * Monetary Policy Report published; ** To be determined.