

Essentials of Monetary Policy

Slow Progress on Inflation Highlighted in the BoC's Hawkish Hold

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According to the BOC

As was widely expected, the Bank of Canada held the overnight policy rate at 5.00% today. The last time the Bank hiked rates was at the July meeting.

Importantly, the Bank recognized in the press release accompanying the rate announcement that, in Canada, "there is growing evidence that past interest rate increases are dampening economic activity and relieving price pressures... Overall, a range of indicators suggest that supply and demand in the economy are now approaching balance."

In this context, the Bank revised down its outlook for 2023 real GDP growth, to 1.2% from 1.8% in the July Monetary Policy Report (MPR). The Bank's newfound pessimism for 2023 growth reflects the downward revision to Q1 (to 2.6% from 3.1% annualized), a weaker-than-expected outturn in Q2 (-0.2% versus 1.5% in the July MPR), and a marked downward revision to Q3 (from 1.5% to 0.7%). 2024 real GDP growth was also revised lower, to 0.9% from 1.2% in July. The 2025 forecast was revised higher by a tick to 2.5%. While this led to a downward revision to the Bank's output gap estimate, the BoC continues to believe the Canadian economy will avoid a recession.

Despite this weaker economic outlook in the October MPR, the Bank marked up its forecast for CPI inflation in each year of the projection. Indeed, the modest upward revision to the 2023 forecast (to 3.9% from 3.7%) was paired with a substantial increase to the 2024 inflation outlook, to 3.0% from 2.5% in July. At the same time, the projection for price growth in 2025 was brought up a tick to 2.2%.

The Bank reiterated its concern that “the labour market remains on the tight side and wage pressures persist” while core inflation has shown “little downward momentum.” Indeed, “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.” As such, today’s interest rate announcement should be considered a ‘hawkish hold’.

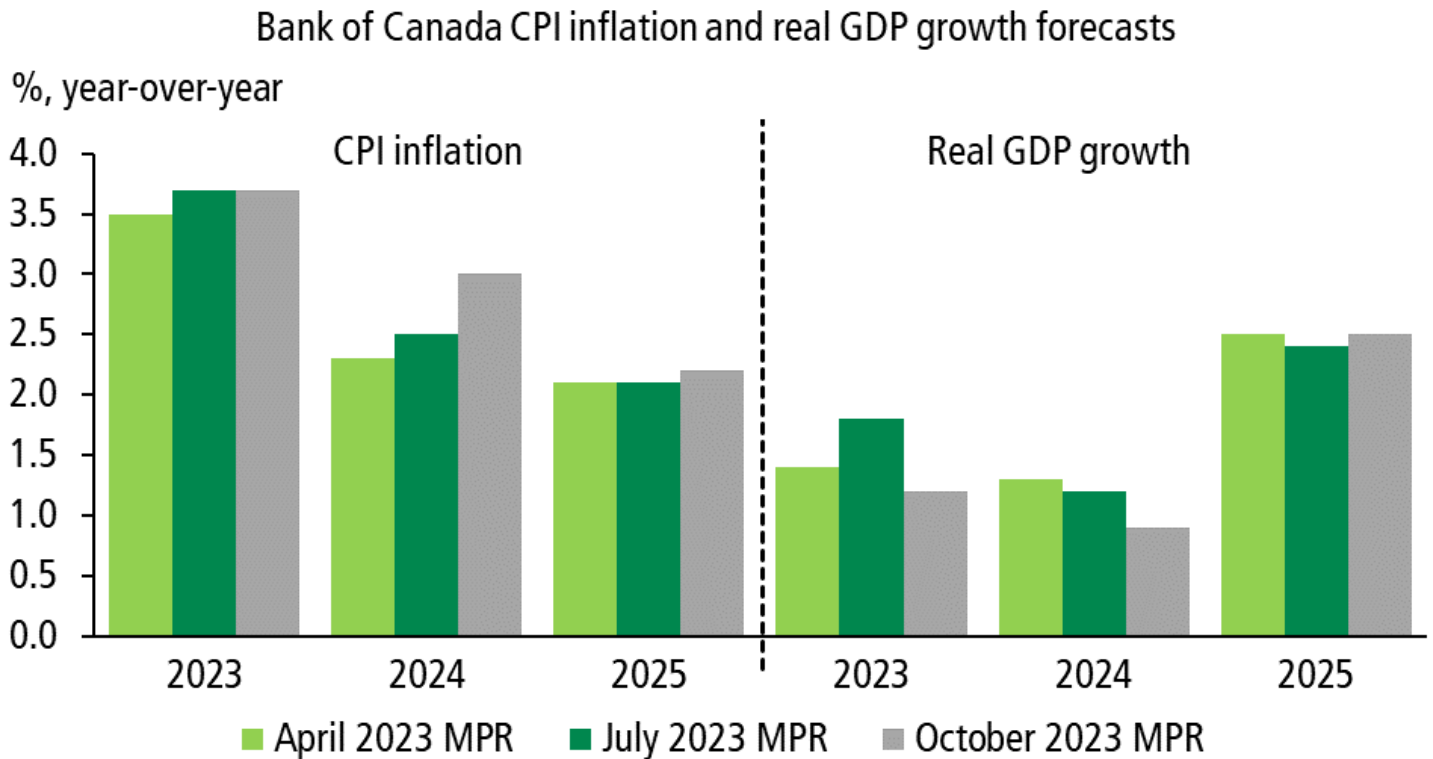
Implications

While today’s interest rate decision didn’t come as a surprise, there was plenty of analysis to chew on in the October MPR. The downgrades to the real GDP growth projection give us further confidence the rate hikes are in the rearview. Sharply higher longer-term yields since September and the quantitative tightening program operating in the background are also working to tighten financial conditions even in the absence of rate hikes. The lagged effect of prior hikes is also a consideration, as more than half of mortgage borrowers have yet to see their payments increase upon renewal. However, the upward revisions to the inflation outlook suggest that the hawkish tone to further rate announcements is likely to persist.

Despite the statement’s hawkish overtones, we think forecasters will be increasingly focused on when the Bank will cut interest rates. According to the latest Bloomberg survey, economists expect the Bank to cut by 25 basis points in the second quarter of 2024 on average. We agree with the timing, but our more bearish outlook—which includes a short, shallow recession in the first half of 2024—points to a more rapid pace of rate cuts once the Bank starts down that path (see our recent [Economic and Financial Outlook](#) for more information).

GRAPH

Forecasts for Inflation Revised Higher and Growth Lower in the Bank's October MPR



Sources: Bank of Canada and Desjardins Economic Studies

2023 SCHEDULE OF CENTRAL BANK MEETINGS

	Central bank	Decision	Rate
January			
12	Bank of Korea	+25 b.p.	3.50
17	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
22	Bank of Korea	unchanged	3.50
March			
6	Reserve Bank of Australia	+25 b.p.	3.60
8	Bank of Canada	unchanged	4.50
9	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
10	Bank of Korea	unchanged	3.50
12	Bank of Canada*	unchanged	4.50
26	Bank of Sweden	+50 b.p.	3.50
28	Bank of Japan	unchanged	-0.10
May			
2	Reserve Bank of Australia	+25 b.p.	3.85
3	Bank of Brazil	unchanged	13.75
3	Federal Reserve	+25 b.p.	5.25
4	European Central Bank	+25 b.p.	3.75

	Central bank	Decision	Rate
July			
4	Reserve Bank of Australia	unchanged	4.10
11	Reserve Bank of New Zealand	unchanged	5.50
12	Bank of Korea	unchanged	3.50
12	Bank of Canada*	+25 b.p.	5.00
26	Federal Reserve	+25 b.p.	5.50
27	European Central Bank	+25 b.p.	4.25
27	Bank of Japan	unchanged	-0.10
August			
1	Reserve Bank of Australia	unchanged	4.10
2	Bank of Brazil	-50 b.p.	13.25
3	Bank of England	+25 b.p.	5.25
10	Bank of Mexico	unchanged	11.25
15	Reserve Bank of New Zealand	unchanged	5.50
17	Bank of Norway	+25 b.p.	4.00
23	Bank of Korea	unchanged	3.50
September			
5	Reserve Bank of Australia	unchanged	4.10
6	Bank of Canada	unchanged	5.00
14	European Central Bank	+25 b.p.	4.50
20	Bank of Brazil	-50 b.p.	12.75
20	Federal Reserve	unchanged	5.50
21	Bank of England	unchanged	5.25
21	Bank of Norway	+25 b.p.	4.25
21	Bank of Sweden	+25 b.p.	4.00
21	Bank of Japan	unchanged	-0.10
21	Swiss National Bank	unchanged	1.75
28	Bank of Mexico	unchanged	11.25
October			
2	Reserve Bank of Australia	unchanged	4.10
3	Reserve Bank of New Zealand	unchanged	5.50
18	Bank of Korea	unchanged	3.50
25	Bank of Canada*	unchanged	5.00
26	European Central Bank		
30	Bank of Japan		
November			
1	Bank of Brazil		
1	Federal Reserve		