

Essentials of Monetary Policy

No Surprises in the Bank's Latest Rate Decision as Economic Slack Continues to Bring Down Inflation

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Randall Bartlett
Senior Director of Canadian Economics

According to the Bank of Canada (BoC)

As was widely expected, the BoC cut the overnight policy rate by 25 basis points to 4.25% today. This is the third consecutive rate cut of the same size since they began in June, after the policy rate reached a peak of 5.00% in July 2023. The Bank also left its quantitative tightening program unchanged.

To justify the rate cut, the Bank pointed to ongoing progress made on fighting inflation. According to the [press release](#) that accompanied the announcement, "With continued easing in broad inflationary pressures, Governing Council decided to reduce the policy interest rate by a further 25 basis points."

In his [press conference opening statement](#), Bank of Canada Governor Tiff Macklem further emphasized that the decision reflected two main considerations. The first is that headline and core inflation have continued to ease as expected. The second is that Governing Council wants to see economic growth pick up to absorb the slack in the economy as inflation gets closer to the 2% target. Importantly, according to Governor Macklem, "If inflation continues to ease broadly in line with our July forecast, it is reasonable to expect further cuts in our policy rate." And so far, inflation is



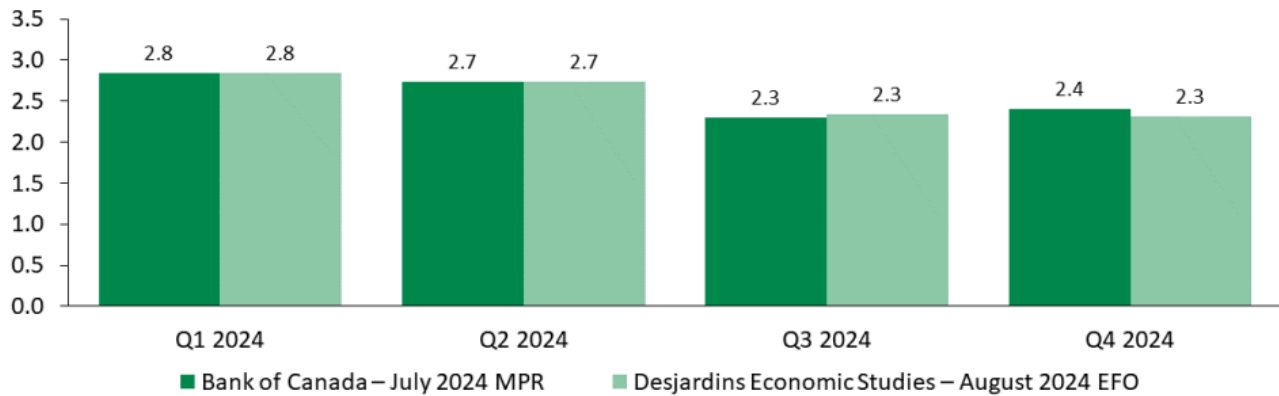
easing in line with the Bank's latest forecast, and we expect that to continue (graph 1).

Graph 1

The Bank of Canada Expects Inflation to Gradually Trend Lower

Bank of Canada CPI inflation forecasts

y/y % change



CPI: Consumer Price Index; MPR: Monetary Policy Report; EFO: Economic & Financial Outlook
Bank of Canada, Statistics Canada and Desjardins Economic Studies

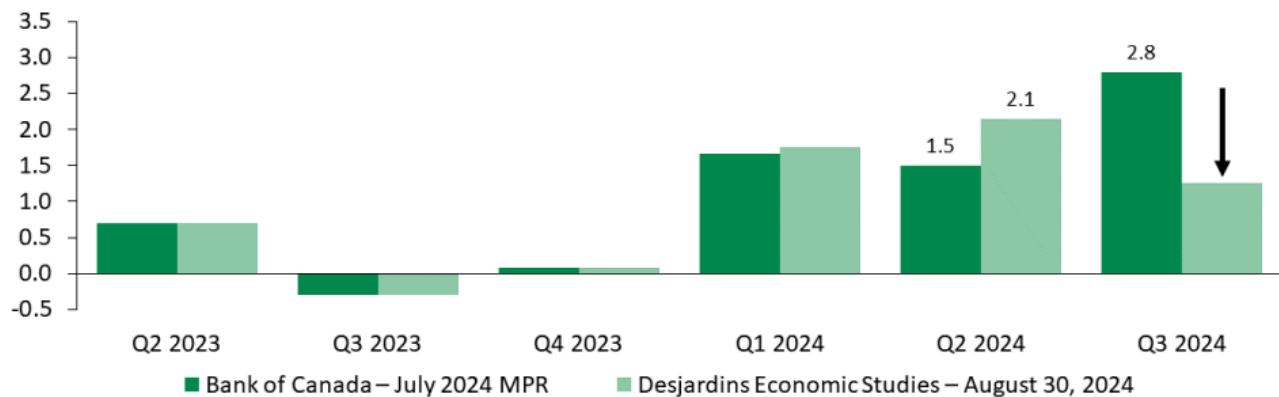
Notably, Governor Macklem recognized that while growth came in somewhat stronger in the first half of 2024 than expected in July, there is downside risk to the Bank's extremely optimistic outlook for Q3 real GDP growth (graph 2). Indeed, our tracking so far in the third quarter is about half the 2.8% annualized pace published in the July 2024 Monetary Policy Report (MPR). This suggests to us that the Bank may be estimating more slack in the Canadian economy than it had been assuming in July. This is happening in a context where inflation is closing in on the target, prompting Macklem to warn about the "need to increasingly guard against the risk that the economy is too weak and inflation falls too much."

Graph 2

The Bank of Canada's Q3 2024 Real GDP Forecast Looks Too Strong

Real GDP growth

%, q/q, seasonally adjusted at annual rates



MPR: Monetary Policy Report

Statistics Canada, Bank of Canada, and Desjardins Economic Studies

Notably, while Governor Macklem did mention the Canadian labour market in his opening statement, he emphasized that recent weakness was concentrated in youth and newcomers, and reflected soft hiring as opposed to business layoffs. “The slack in the labour market is expected to slow wage growth, which remains elevated relative to productivity.” This should further support a reduced pace of services and core inflation.

Implications

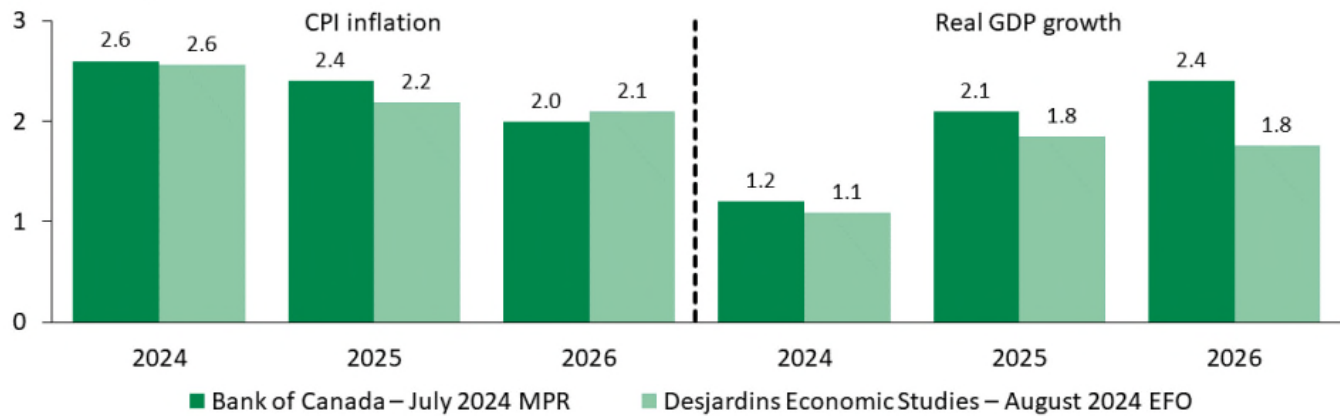
While today's rate cut didn't come as a surprise and still isn't enough to spur a recovery in the economy, the guidance on future rate decisions, conditional on inflation, suggests that policymakers are ready to continue easing policy. Indeed, we're of the view that the economy is likely to underperform the Bank's optimistic July outlook and pull inflation lower than the BoC's projection as a result (graph 3). While this may increase the chances of an accelerated pace of rate cuts, our base case forecast still sees 25 basis point rate reductions in October and December of this year, and six more in 2025.

Graph 3

We Expect Inflation and Growth to be Weaker than the Bank of Canada Projects

CPI inflation and real GDP growth forecasts

y/y % change



CPI: Consumer Price Index; MPR: Monetary Policy Report; EFO: Economic & Financial Outlook

Bank of Canada, Statistics Canada and Desjardins Economic Studies



2024 Schedule of Central Bank Meetings

Central bank	Decision	Rate
January		
11 Bank of Korea	unchanged	3.50
22 Bank of Japan	unchanged	-0.10
24 Bank of Canada*	unchanged	5.00
25 European Central Bank	unchanged	4.50
25 Bank of Norway	unchanged	4.50
31 Bank of Brazil	unchanged	11.25
31 Federal Reserve	unchanged	5.50

February		
1 Bank of England	unchanged	5.25
1 Bank of Sweden	unchanged	4.00
5 Reserve Bank of Australia	unchanged	4.35
8 Bank of Mexico	unchanged	11.25
21 Bank of Korea	unchanged	3.50
27 Reserve Bank of New Zealand	unchanged	5.50

March		
6 Bank of Canada	unchanged	5.00
7 European Central Bank	unchanged	4.50
18 Reserve Bank of Australia	unchanged	4.35
18 Bank of Japan	+20 b.p.	0.10
20 Bank of Brazil	-50 b.p.	10.75
20 Federal Reserve	unchanged	5.50
21 Bank of England	unchanged	5.25
21 Bank of Norway	unchanged	4.50
21 Bank of Mexico	-25 b.p.	11.00
21 Swiss National Bank	-25 b.p.	1.50
27 Bank of Sweden	unchanged	4.00

April		
9 Reserve Bank of New Zealand	unchanged	5.50
10 Bank of Canada*	unchanged	5.00
11 European Central Bank	unchanged	4.50
11 Bank of Korea	unchanged	3.50
25 Bank of Japan	unchanged	0.10

Notes

May		
1 Federal Reserve	unchanged	5.50
3 Bank of Norway	unchanged	4.50
7 Reserve Bank of Australia	unchanged	4.35
8 Bank of Sweden	-25 b.p.	3.75
8 Bank of Brazil	-25 b.p.	10.50
9 Bank of England	unchanged	5.25
9 Bank of Mexico	unchanged	11.00
21 Reserve Bank of New Zealand	unchanged	5.50
22 Bank of Korea	unchanged	3.50

June		
5 Bank of Canada	-25 b.p.	4.75

Central bank	Decision	Rate
July		
9 Reserve Bank of New Zealand	unchanged	5.50
10 Bank of Korea	unchanged	3.50
18 European Central Bank	unchanged	4.25
24 Bank of Canada*	-25 b.p.	4.50
30 Bank of Japan	+15 b.p.	0.25
31 Bank of Brazil	unchanged	10.50
31 Federal Reserve	unchanged	5.50

August		
1 Bank of England	-25 b.p.	5.00
6 Reserve Bank of Australia	unchanged	4.35
8 Bank of Mexico	-25 b.p.	10.75
13 Reserve Bank of New Zealand	-25 b.p.	5.25
15 Bank of Norway	unchanged	4.50
20 Bank of Sweden	-25 b.p.	3.50
21 Bank of Korea	unchanged	3.50

September		
4 Bank of Canada	-25 b.p.	4.25
12 European Central Bank		
18 Bank of Brazil		
18 Federal Reserve		
19 Bank of England		
19 Bank of Norway		
19 Bank of Japan		
24 Reserve Bank of Australia		
25 Bank of Sweden		
26 Bank of Mexico		
26 Swiss National Bank		

October		
8 Reserve Bank of New Zealand		
10 Bank of Korea		
17 European Central Bank		
23 Bank of Canada*		
30 Bank of Japan		

November		
4 Reserve Bank of Australia		
6 Bank of Brazil		
7 Bank of England		
7 Bank of Norway		
7 Bank of Sweden		
7 Federal Reserve		
14 Bank of Mexico		
26 Reserve Bank of New Zealand		
27 Bank of Korea		

December