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Bank of Canada mulled rate hike in face of stubborn inflation

Deliberations show concerns the pause in September would send message that rate cuts were coming

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Bank of Canada governor Tiff Macklem and his team mulled an interest rate hike on Sept. 6, deliberations showed. PHOTO BY PATRICK DOYLE/The Canadian Press

When the governing council of the Bank of Canada met at policy-setting meetings beginning Aug. 31 to consider pausing or increasing the central bank's key overnight interest rate, they concluded that earlier rate hikes were beginning have an effect on the economy.

“Members agreed that data since their last decision had shown more clearly that demand was slowing, and excess demand was diminishing as monetary policy gained traction,” said a summary of those deliberations released Sept. 20.

“In particular, demand had levelled out in several industries in the services sector, suggesting that the impact of higher interest rates had broadened.”

However, the central bankers continued to view the lack of progress on tackling underlying inflation as a significant concern, and they considered raising the key overnight rate yet again before ultimately deciding to leave it at five per cent at the Sept. 6 rate setting.

“Members weighed the possibility that high core inflation could persist even as evidence accumulated that restrictive monetary policy was slowing demand,” according to the summary of deliberations, which highlighted wage growth as a key factor in reducing downward momentum in core inflation.

The central bankers said annual wage increases — with most measures of wage growth remaining in a four to five per cent range annually — were “inconsistent with achieving price stability” in the absence of a large increase in productivity.

They also noted that international oil prices were higher than had been assumed in July, representing a potential source of inflationary pressures, and that global oil prices hadn’t come down despite slowing growth in China.

The central bankers said they expected oil and gas prices to drive headline inflation higher over the next few months even if inflation eases on food.

“Data showed little progress on core inflation since the July interest rate announcement, with many measures proving to be sticky,” the summary of deliberations said. “Both year-over-year and three-month measures of core inflation had settled around 3.5 per cent, suggesting little near-term downward momentum in core inflation.”

The summary of deliberations shows that the central bankers also took note of one-off factors that held back economic output in the second quarter, including wildfires that affected the oil and gas and mining sectors and reduced economic growth by around 0.5

percentage points. Strikes in the public sector were estimated to have lowered quarterly growth by about 0.25 percentage points, according to the summary of deliberations.

The September decision to hold rates followed a string of interest rate hikes with few pauses since early 2022, with the latest 25-basis-point increase in July.

The summary of deliberations shows that the central bankers were concerned the pause in September would convey the message that rate hikes were done and that lower rates would follow, a view they hoped to blunt by pointing out that their decisions are meant to balance the risks of over-tightening and under-tightening.

“They agreed that they did not want to raise expectations of a near-term reduction in interest rates, given that they only considered keeping the policy rate where it is or raising it further,” the summary of deliberations says.

“They decided to stress that they will pay close attention to the evolution of data as they balance the risks of over-tightening and under-tightening monetary policy. Governing Council will continue to focus on the assessment of the dynamics of core inflation and the outlook for CPI inflation.”