THE OWL

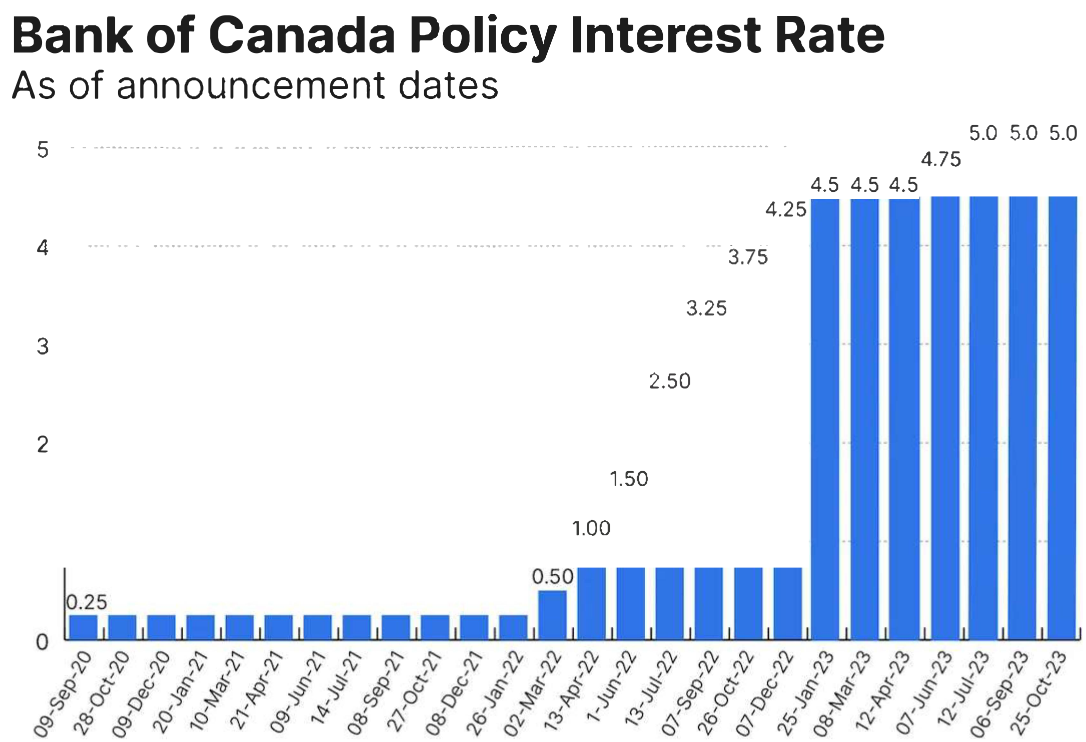
Focused on Alberta's economy

Mark Parsons, ATB ECONOMICS | October 25, 2023

Holding the line: A 'hawkish' rate pause and growth downgrade

As expected, the Bank of Canada announced this morning that it is keeping its trend-setting policy interest rate at 5%. This is the second announcement in a row without an increase. Since March 2022, the Bank of Canada has hiked its policy rate by 4.75 percentage points.

We were expecting a pause today, given last week’s pullback in headline and core inflation and signs that the economy is slowing under the weight of higher interest rates.



Source: Bank of Canada

With this announcement, the Bank of Canada is expecting that the economic slowdown from previous hikes will grind inflation lower. The Bank noted this is already happening: “In Canada, there is growing evidence that past interest rate increases are dampening economic activity and relieving price pressures." It also said "a range of indicators suggest that supply and demand in the economy are now approaching balance." The September statement spoke of "recent evidence that excess demand in the economy is easing."

The statement maintains a 'hawkish' tone set in the previous announcement. Despite progress, the Bank remains concerned by stubbornly high inflation and is willing to raise rates again if inflation doesn't cooperate. "The Bank's preferred measures of core inflation show little downward momentum." The Bank kept its "prepared to raise rates" warning from September: "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." The 'wait and see', data dependent stance was reiterated, with a focus on core inflation readings.

Today's announcement was accompanied by a fresh set of forecasts in the Monetary Policy Report (published four times a year). As expected, the Bank of Canada downgraded its forecast for the Canadian economy.

Canadian real GDP is now expected to expand by 1.2% in 2023, compared to 1.8% in the July forecast. The 2024 forecast was also downgraded to 0.9%. While a marked downward revision, this forecast is still consistent with a soft landing scenario. Third and fourth quarter growth of 0.8% (annualized) are forecast, following a mild contraction (-0.2%) in the second quarter. Recall that the Bank's previous forecast came before the release of the second quarter GDP numbers, which showed a 0.2% contraction (versus a 1.5% increase in the July Monetary Policy Report).

Inflation forecasts were revised up this year and next. The return to target is still on track for 2025, but higher inflation is now expected in the near term: “Inflation returns to target about the same time as in the July projection, but the near-term path is higher because of energy prices and ongoing persistence in core inflation.”

The Bank of Canada’s next rate decision is scheduled for December 6, 2023.

Bank of Canada Canadian economy forecasts

	Real GDP (% change)	CPI inflation (%)
2023	1.2 (1.8)	3.9 (3.7)
2024	0.9 (1.2)	3.0 (2.5)
2025	2.5 (2.4)	2.2 (2.1)

July forecast in parenthesis

Source: Bank of Canada, Monetary Policy Report, October 25, 2023

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