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'The BoC wants to pop the housing bubble': How economists and markets are reacting to Wednesday's rate decision

DARCY KEITH || JANUARY 24, 2024

The Bank of Canada Wednesday held its policy interest rate steady at 5 per cent for the fourth consecutive time while offering up a notable pivot in the language of its accompanying statement that opened the door to possible rate cuts later this year.

The rate decision was widely expected, and while the language could be interpreted as mildly dovish, money markets actually lowered the odds of a near-term rate cut by the Bank of Canada.

Implied interest rate probabilities in the swaps market now suggest only about a 6 per cent chance of a quarter-point rate cut at the bank's next meeting in March, down from 28 per cent prior to today's decision. For April, money markets are now pricing in a 45 per cent chance of the first rate cut, down from 55 per cent.

Money markets now assign a 77 per cent chance of that first move happening in June, down slightly from 80 per cent prior to the 945 am ET decision.

But overall, markets - as well as most economists - are confident rate cuts are coming sometime either this spring or summer. And Canadian bond yields - as well as the Canadian dollar - held relatively steady following today's decision.

The following table details how money markets are pricing in further moves in the Bank of Canada overnight rate, according to Refinitiv Eikon data as of 1119 am Wednesday, which is when the BoC press conference on the decision concluded. The current Bank of Canada overnight rate is 5%. While the bank moves in quarter point increments, credit market implied rates fluctuate more fluidly and are constantly changing. Columns to the right are percentage probabilities of future rate moves.

MEETING DATE	EXPECTED TARGET RATE	CUT	NO CHANGE	HIKE
6-Mar-24	4.9834	6.6	93.4	0
10-Apr-24	4.8807	45	55	0
5-Jun-24	4.7334	77.4	22.6	0
24-Jul-24	4.5236	96.4	3.6	0
4-Sep-24	4.3984	98.2	1.8	0
23-Oct-24	4.1575	99.9	0.1	0
11-Dec-24	4.0529	100	0	0

And here's how interest rate probabilities looked just prior to the 945 am ET policy announcement:

MEETING DATE	EXPECTED TARGET RATE	CUT	NO CHANGE	HIKE
24-Jan-24	4.9635	14.6	85.4	0
6-Mar-24	4.9227	28.5	71.5	0
10-Apr-24	4.8302	55	45	0
5-Jun-24	4.6915	80	20	0
24-Jul-24	4.4976	95.5	4.5	0
4-Sep-24	4.3741	97.7	2.3	0
23-Oct-24	4.1436	99.8	0.2	0
11-Dec-24	4.0371	99.9	0.1	0

Here's how economists are reacting in written statements following the decision:

David Rosenberg, economist and founder of Rosenberg Research

The Bank of Canada is detaching itself from the global monetary policy cycle and the "hawkish/dovish" continuum — call it "Loonish." The Bank has an idiosyncratic policy aim: trying to pop the local housing bubble. Of course, they can't say that explicitly, so their communication is couched as a laser focus on bringing down CPI shelter costs (inclusive of rents, mortgage costs, insurance, and other household services) to get core inflation sustainably into the target range. But none of that happens without housing prices falling. Put the housing market at the top of the list of things the BoC cares about, and an otherwise puzzling policy stance falls into place. ...

The tone around inflation in the Statement and press conference was decidedly hawkish, with Governor Macklem spending a significant share of his time pointing out that housing costs remain elevated, holding up further moderation in core inflation and delaying the return to target. The Governor pointed to mortgages, insurance costs, and

other housing related costs as public enemy number 1. The hawkishness on inflation was reinforced by the discussion on interest rates, with Tiff taking care to emphasize in the press conference that hikes have not been taken off the table, and refusing to be drawn into commenting on whether cuts were discussed at the meeting. Instead, he framed the current debate on the Council as being about how long it will be necessary to hold policy at highly restrictive levels.

So, activity and incomes are tanking, the lagged impact of prior hikes is working, labor markets are easing, and inflation is expected to moderate toward target, even with core currently misbehaving a little. Sounds like a case for a dovish outlook — so how do we interpret the BoC wanting to hold on to its tight stance? Bearing in mind that the Bank can bring down shelter inflation any time it wants by cutting the policy rate and thereby reducing the mortgage costs that are included in Canadian CPI, that and immigration-related pressure on rents is not directly under their control, there is only really one interpretation that makes sense: the BoC wants to pop the housing bubble.

Despite recent moderation, high house prices remain the biggest imbalance in the Canadian economy at present. And when you think about it, bringing them down is something of the magic bullet for all the other concerns the Governor expressed. Rents and house prices are connected, so pushing down on house prices will eventually feed through to the elements of the rental markets that the Bank can control. They also define insurance costs and other household services prices. Second-round effects matter too; bringing down prices will make efforts to expand the housing supply easier by keeping costs down, sparking off a virtuous cycle of improving affordability and availability.

You heard it here first: “Loonish” monetary policy means looking through the marginal hawkish/dovish signals in the data and focusing squarely on the housing market. To play Canadian interest rates, look no further than house prices.

Avery Shenfeld, managing director and chief economist of CIBC Capital Markets

The Bank of Canada isn’t ready, willing or able to bring interest rate relief just yet, but dangled some hints that lower rates are on the way later this year. … The statement dropped the earlier reference to a potential need to hike if inflation failed to cool, changing it into a less hawkish comment that they remain “concerned” about persistent core inflation. But in a growth and inflation forecast that’s little changed for the next two years, it sees weak growth in the first half of 2024 forecast with more disinflationary slack emerging, and an output gap estimate centred on -0.75% as of the end of 2023. The pick-up in growth projected for the back half of the year might well be tied to their own expectations for lower rates at that time, since the Governor noted that the meeting has shifted from a discussion of whether rates are high enough to one about how long they need to keep rates at 5%. That’s a dovish tilt, but is still consistent with our call for a first rate cut in June, with as much at 150 bps of cuts on tap this year if, as we expect, we’ll need that to get the economy moving again after its current stall.

Stephen Brown, deputy chief North America economist with Capital Economics

The Bank of Canada's decision to drop its tightening bias today is the first step toward interest rate cuts. We continue to think that the Bank's forecasts for the economy are too optimistic, and that inflation will slow faster than the Bank expects, leading us to forecast the first rate cut in April.

The big change in the policy statement was that the Bank dropped its bias toward more tightening. In the accompanying opening statement to the press conference, which is now released alongside the policy statement, Governor Tiff Macklem notes that "Governing Council's discussion of monetary policy is shifting from whether our policy rate is restrictive enough to restore price stability, to how long it needs to stay at the current level".

While that means we are one step closer to interest rate cuts, there was no sign that cuts are imminent. ... That said, the Bank does also acknowledge that shelter costs – mortgage interest costs and rents – are playing an outsized role in driving headline inflation, while "the share of consumer price index (CPI) components that are rising faster than 3% has declined substantially and should continue to normalize". All this suggests that the Bank shares our view that inflationary pressures have eased by more than the headline CPI figures might suggest.

The Bank's new GDP and inflation forecasts remain stronger than our own, with the Bank still seemingly of the view that the economy will avoid a recession. It forecasts GDP growth of 0.8% this year compared to our forecast of 0.0%, and the Bank still thinks it will take until 2025 for headline inflation to return to 2% – we expect that to occur in the third quarter.

Royce Mendes, managing director and head of macro strategy at Desjardins Securities

The Bank of Canada no longer sees the economy as overheated. The central bank now estimates that the economy is operating with a modest amount of slack. With the economy underperforming and expected to stagnate in the near-term, the reality is that the bar for any additional rate hikes is extremely high at this point.

We continue to believe that rate cuts will begin as early as April. The economy is facing a set of unique challenges in the form of the rising impact of mortgage renewals, slower population growth and CEBA loan repayments. As a result, central bankers should be able to begin easing policy to a less restrictive stance in the not-so-distant future.

Philip Petursson, chief investment strategist at IG Wealth Management

The tone of the statement said it all. The Bank outlined the case for slower global economic growth while seemingly acknowledging that the Canadian economy is in a recession. With comments that the "economy has stalled since the middle of 2023 and

growth will likely remain close to zero through the first quarter of 2024″, the Bank is all but using the "R" word.

Despite inflation ticking higher for December, the BoC is no doubt aware that excluding mortgage interest costs, inflation on a year-over-year basis was 2.5% and well within the BoC's target range. The BoC has to realize that the higher interest rates are keeping headline inflation higher, not lower. It is therefore without a doubt that the direction for rates is lower, not higher.

The statement continued along the narrative that the Governing Council wants to see further and sustained easing in core inflation while also highlighting that shelter costs remain the biggest contributor. If it weren't for the already weakened Canadian economy, we may have taken this more seriously that this might suggest rate cuts are further out, but that's not likely the case. Trying to read between the lines as to when the Bank might initiate its first cut leads to a second quarter target. To support the Bank's belief that household spending "will likely pick up" in the second half of 2024, we would need to see relief for the consumer. That relief can only come with interest rate cuts given the current mortgage and rent burden. We are zoning in on the path to cuts – if not April than most certainly June.

Robert Kavcic, senior economist, BMO Capital Markets

The Bank of Canada dealt no surprises leaving rates unchanged on Wednesday and, while language changes show even more clearly that they are done raising rates, rate cuts are still some time off. Indeed, after the market got a bit too ahead of itself pricing in near-term rate cuts to start 2024, we continue to look for a June move. For mortgage rates, this means that more relief is going to have to wait. Lower five-year fixed rates and expectations that the 'worst for rates is over' will likely set up a firm spring market, but a recent modest back-up in yields could stall that downward rate momentum. Variable rate cuts, of course, would be a story for the second half of the year. Overall, rate relief is still on the horizon, it's just going to take some more slogging to get there…

Derek Holt, vice-president and head of Capital Markets Economics, Scotiabank

The Bank of Canada broadly delivered upon expectations. It's easy to do when they are set rather low to begin with. Nothing was changed. Nothing at all. Policy measures were left intact as expected. No material changes to their prior round of forecasts in October were offered. It's as if time stood completely still since the last forecasts on October 25th when in reality so much change is afoot. I don't find that satisfying when you've got a few hundred folks involved in the process.

The overall set of communications left us with the exact same understanding of the BoC perspective that we've had for months. Their growth and inflation forecasts were hardly changed at all. Their models continue to forecast a nice, neat, perfect landing on 2% next year in strict adherence to the general equilibrium properties that guide them. If you buy their ongoing view that inflation will durably land on 2% into next year as they

basically always forecast and simply have to forecast, then a forward-looking central bank will be cutting probably around the middle of this year, give or take. That's what everyone is hanging their view upon and what is roughly priced. In reality, they can't forecast inflation.

Charles St-Arnaud, chief economist with Alberta Central

We believe that the BoC will likely stay on hold until late spring to mid-year, when the opportunity for a cut will present itself. We believe that the BoC is unlikely to consider lowering its policy rate until the inflation is viewed as sustainably below 3%. This likely means that its preferred core inflation measures and their momentums are around or below 2.5%, something we do not expect until May 2024. However, a much weaker economy 2024 is a risk that could force the BoC to move sooner. … Whether we see an underperformance in hiring or job losses will determine whether we have a hard or soft landing in 2024.

James Orlando, director and senior economist, TD Economics

The Bank of Canada held the line today, but is starting to shift its tone in stronger acknowledgement of the problematic forces of shelter costs. Since the spring, BoC rhetoric has focused on the clear signs of weakness within the economy and this was feeling long in the tooth, now complemented by the dichotomy occurring between shelter costs and the opposing price dynamics elsewhere in the economy. What we know is that Canadians have cut spending over the last year (on a per person basis) as high rates have tightened consumers' purse strings. Normally this would cause inflation to decelerate quickly, but structural imbalances in the real estate sector are keeping the BoC's preferred inflation gauges elevated. …

While the Bank isn't yet ready to signal a change in policy, markets are taking the lead. Odds are pointing to the first rate cut happening in April/June. We echo this sentiment. The BoC's tight policy has caused the economy to flatline since last summer, which has quickly pushed the job market back into balance. Even the BoC's quantitative tightening policy looks to have potentially gone too far with market overnight rates continuing to drift from the Bank's target rate. With this alongside the realization that the BoC can't set policy just based on elevated shelter inflation, it is clear that the central bank is getting ready to signal a rate cut in the coming months.

Benjamin Reitzes, managing director, Canadian rates and macro strategist, BMO Capital Markets

Perhaps the most important part of the statement is that the Bank believes that the Canadian economy is now running in excess supply. That should be encouraging for policymakers as it drives disinflationary pressure. However, we're not there yet, and inflation remains a concern given "the persistence in underlying inflation." Indeed, near the beginning of Governor Macklem's opening statement he says that "We need to give these higher rates time to do their work." And, toward the end, reiterates with "Monetary policy is working, and we need to continue to let it work."

The rapid and sizeable rate hikes over the past two years are doing their job, but it looks like we'll be at 5% for a while yet as the BoC wants to see a further slowing in inflation. BMO's call for a June start to rate cuts looks perfectly reasonable at the moment.

National Bank economists Taylor Schleich, Jocelyn Paquet and Warren Lovely

The BoC left its policy rate unchanged but did not retain its explicit hiking bias. This is somewhat surprising to us given the recent strength in core inflation measures, however these pressures don't appear to have meaningfully altered their outlook for inflation based on fresh forecasts. They also seem to be putting more weight on softening economic conditions, as the BoC now sees the economy operating in modest excess supply (a deterioration versus December's characterization). On balance, the statement is marginally more dovish than we'd feared and the shifting stance advances the process towards an eventual policy rate pivot. Our read of this statement gives us a bit more confidence in our forecast for an April rate cut. When it comes to quantitative tightening, we were extremely surprised that there was no mention made of recent pressures in the repo market and thus on CORRA (Canadian Overnight Repo Rate Average). To us, this clearly warrants discussion and should've probably appeared in some capacity in the Monetary Policy Report.

Nathan Janzen, assistant chief economist, Royal Bank of Canada

Interest rates are already at levels that are high enough to restrict economic activity and wobbly-looking GDP growth and labour market backdrops mean the most likely trajectory for inflation going forward is still lower. 'Core' inflation measures have not yet shown the 'sustained' downward pressure towards the 2% target rate the BoC wants to see before pivoting to interest rate cuts. But we expect slower price growth alongside a weakening economic backdrop will push the BoC to start gradually lowering the policy rate late by mid-year.

Nick Rees, forex market analyst at Monex Europe and Canada

As noted by Governor Macklem in his press conference, the Governing Council's discussion of monetary policy is shifting from whether our policy rate is restrictive enough to restore price stability, to how long it needs to stay at the current level. In this context, the Governor's attempt to emphasise inflationary stickiness and upside risks rang somewhat hollow, not helped by his inability to give a clear answer when questioned directly on the possible timing for rate cuts.

Indeed, we think today's communications signal the clear beginning of a pivot towards policy easing, one that is likely to come sooner than Governor Macklem is currently willing to admit. If economic conditions continue to evolve as we expect, undershooting BoC forecasts, we think the timing for rate cuts could come as soon as the April meeting.