

## Economics

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## Bank of Canada: Even more to come?

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The Bank of Canada delivered the 25bp hike that was widely expected today, taking the overnight rate up to 5.0%, in light of evidence that excess demand and core inflation are proving "more persistent" than expected and a revised forecast that suggests inflation will take longer to return to its 2% target. The continued hawkish tone within today's statement and MPR also suggests that another move could well be seen in September, although we suspect that this will ultimately prove to be an overshoot, and because of that we are also bringing forward our projected first interest rate cut from June 2024 to April.

The Bank of Canada's forecast for growth and inflation were generally higher than in April's Monetary Policy Report (MPR). Quarterly growth is expected to be 1.5% in both the second and third quarters, with the former forecast representing a 0.5%-pts upgrade relative to the prior MPR. The Bank's full year growth forecasts of 1.8% for 2023 and 1.2% for 2024 are both modestly higher than our expectation, particularly in relation to the outlook for consumer spending. The BoC expects that the large accumulation of savings during the pandemic, as well as the current strength of the labour market, will protect households that are now facing higher debt-service costs. However, there was an acknowledgement that the apparent financial health of households may change as economic circumstances evolve.

The updated forecasts for inflation are also higher relative to the prior MPR, with a return to 2% achieved later than previously anticipated. While lower energy assumptions mean that the headline forecasts don't seem particularly high or different, the Bank stated that projections for core inflation were upgraded by as much as 0.5%-pts for the first quarter of 2024 due to the persistence of excess demand and an earlier than anticipated rebound in house prices. Inflation in line with the Bank's 2% inflation target is now expected to be achieved by mid-2025, rather than by the end of 2024.

**Re: Economic forecast** — With expectations for near-term GDP growth set higher than has been typical in recent MPR's, and with the Bank having now pushed back its projection for inflation returning to target, there appears to be greater scope for the economy to underperform the BoC's current forecasts from here and for inflation to make quicker progress back to target than the Bank expects. However, that underperformance may not come soon enough to prevent another 25bp hike at the September meeting, which given the tone today now seems likely. These recent interest rate hikes may ultimately, however, prove to be more than is needed to bring inflation back down to target, and as a result we have pulled forward our expectation for the first rate cut in 2024 slightly to April, from June previously.

**Re: Markets** — Bond yields were lower on the day going into the Bank decision, following some weaker than expected US CPI data released earlier in the session, and didn't move much following the expected 25bp hike. However, the Canadian dollar did continue to strengthen against its US counterpart.

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