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Bank of Canada toasts some small victories

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- The Bank of Canada's toasted some small victories in its battle against inflation in unveiling its easy decision to leave interest rates unchanged today, but wasn't yet willing to break out the champagne and declare that the battle has been won. The statement didn't drop the earlier warning that additional rate hikes could still be in the offing if inflation fails to sufficiently cool. But other signals in today's announcement suggest that the Bank isn't really giving serious thought to the prospect of further rate hikes, and simply wants to save any major signals about what lies ahead for a meeting accompanied by a new Monetary Policy Report with a fresh economic forecast.
- So where are the toasts to some smaller victories against inflation? Most notably in the conclusion that the economy is "no longer in excess demand", since the prior statement only suggested we were approaching that condition. That same judgement was recognized in dropping the description of the labour market as "tight". Given that the Bank of Canada isn't as reliant on the "output gap" approach to measuring slack (due to uncertainties over potential GDP), its really relying on the labour market to judge whether we're overheated or not. The jobless rate and job vacancy rates aren't now materially out of line with where we were prior to the pandemic, when inflation was subdued.
- Of course, neither prices nor wages are yet running at a pace consistent with the Bank's 2% inflation target. The Bank noted that CPI had decelerated to 3.1%, but rather than seeing the last report as a true breakout to the downside, it described core measures as still in the 3 1/2% to 4% range (while conceding that the last data point was at the low end of the range). Similarly, it mentioned wage inflation in the 4-5% range, which elsewhere it had deemed to be inconsistent with meeting its inflation target in the absence of a productivity surge.
- In not raising rates, the Bank is clearly counting on a move from an overheated economy to one with economic slack to put downward pressure on wage and price inflation, with the usual lags between economic conditions and inflation explaining why we haven't yet seen enough of that deceleration. The Bank gave a favourable nod to the fact the recent slowing in inflation, unlike the initial move that was concentrated in gasoline prices, has now been "broadening" to more items. Shelter costs were cited as a countertrend given their recent acceleration, but part of that was attributed to higher mortgage rates, which of course could be eased once the Bank of Canada takes policy rates lower.
- The rest of the statement was either in line with earlier messages from the Bank, or simply descriptive of the facts seen in recent weeks, including evidence of a stall in Canadian growth, sluggish global growth (outside the US), and softening inflation in other countries. Quantitative tightening is on autopilot at this point, and will be maintained until the Bank reaches its objectives for the size of its balance sheet.

Re: Economic forecast — We'll stick to our view that the Bank of Canada will begin easing by June 2024, a bit later than where markets now see it, but then easing more aggressively than market expectations. We see the overnight rate at 3.5% by the end of 2024, a full 150 bps lower than today, but still twice the peak rate of interest in the prior cycle.

Re: Markets — This statement had some important content, particularly in concluding that labour markets and the overall economy were no longer overheated. But markets were well ahead of the Bank in judging that we've seen the last of the rate hikes, so there was no reason for any reaction to the statement today.

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