ECONOMIC RESEARCH AND STRATEGY

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Bank of Canada March Policy Decision – Cooling CPI inflation takes time, no imminent policy rate cuts in sight

The Bank of Canada (BoC) left its overnight rate target unchanged at 5% this morning. Additionally, quantitative tightening, reducing balance sheet holdings, remains on cruise control.

Nothing materially moved the needle since the previous January decision. Back then, BoC officials' discussion shifted away from whether to hike rates to how long the policy rate will stay at 5%. Today, the BoC acknowledged some progress, taking the form of a total CPI headline figure easing to 2.9% in January. However, this progress is insufficient. Today's statement refers to the persistence of "underlying inflationary pressures". First, core CPI measures are slightly above 3%, both on a year-over-year and 3-month annualized basis. Second, the share of items in the CPI basket running above 3% year-over-year fell slightly below 50% in January. However, the situation is far from normal days when 20% of prices rose at an annual pace of 3% and over. In addition, our team closely monitors the survey of business conditions released by Statistics Canada. The latest survey, released in late February, indicates a slightly higher share of companies planning to increase prices in 2024Q1 relative to 2023Q4, showing a halt in progress relative to the normalization of corporate pricing behaviour.

In our view, total CPI inflation of 2.9% in January will not show additional cooling progress in February and March. Financial markets will have to wait for the release of the April CPI report to see total CPI inflation falling close to 2.5%. While total CPI inflation may decline, the modest excess supply situation of the Canadian economy might not cool down core inflation fast enough and bring it sufficiently below 3% to allow the BoC to reduce its policy rate in June as our team has been predicting since late 2023. Indeed, discussing the possibility of policy rate cuts within the BoC is a distant subject, as BoC officials "want to see a further deceleration in core inflation in the coming months". As such, a first policy rate cut in July or September appears more suitable given recent economic conditions and the near-term path, considering the risk of under- and over-shooting monetary policy. Furthermore, the cumulative drop in the policy rate during the second half of 2024 could be slight, about 75 basis points (from 5.00% to 4.25%) rather than 125 basis points.

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