ECONOMIC RESEARCH AND STRATEGY

LAURENTIAN BANK

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Bank of Canada Policy Decision – Cautious Pause

The overnight rate target was left unchanged this morning at 5.00%. The Bank of Canada (BoC) is at another crossroad. Governor Macklem had mentioned the delicate balance of under- and overshooting during his July press conference, the theme emerging as the main takeaway of today's statement.

First, the BoC opts for a cautious pause due to the reaction of Canadian consumers to higher interest rates: consumer spending per capita is pulling back. The BoC took notice like many, saying "the Canadian economy has entered a period of weaker growth" and that "excess demand in the economy is easing".

Second, it is the first time the BoC cites the "lagged effects of monetary policy" in the statement, a sign that we are at or very near the peak for the policy rate. The pause is cautious in the sense that it would be risky to say the tightening cycle is over. BoC officials monitor inflation expectations (cooling underway), wage inflation (no moderation at this stage), and corporate pricing behaviour. About the latter, we see encouraging progress. First, Statistics Canada's Survey of Business Conditions for 2023Q3 revealed that the percentage share of companies planning to increase prices decreased to 25.9%, down from 30%+ figures in prior quarters. Second, the August business survey conducted by the Canadian Federation Independent Business indicated an average price increase intention of 3% for the next 3-4 months, lower than the 3.3%-3.7% range observed earlier this year.

Of course, the cooling of inflation is not a perfect, straight downward line. The BoC expects a mild, brief acceleration in CPI inflation in the near term. Our interpretation is that the BoC will not overact to this bump but extend the pause at the late October and early December meetings. In our view, the BoC will keep its policy rate at this sufficiently restrictive level of 5.00% for as long as necessary until CPI inflation cools to a respectable zone. We do not expect Governor Macklem to say this during his speech at the press conference tomorrow afternoon, but the combination of recent developments and deteriorating outlook could bring the next move to be a rate cut rather than a rate hike, somewhere near mid-2024. The magnitude of eventual cuts, however, could be small relative to previous easing cycles. The BoC statement is hawkish enough to prevent borrowers from having a false hope of large interest rate cuts in 2024. After all, CPI inflation is cooling but is relatively elevated considering that Canada has entered a challenging period of either stagnation or a mild recession.

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