Key rate hikes appear to be over: the Bank of Canada is in neutral for the months to come

According to the Bank of Canada:

• The overnight rate and the Bank Rate rise 0.25% to 4.25% and 4.50% respectively.
• The strong momentum in the global and Canadian economies has continued. Domestic demand remains solid and inflation is evolving largely in line with the Bank’s expectations.
• There has recently been an increased degree of volatility in financial markets, particularly foreign exchange markets and commodity markets.
• With today’s increase, the target for the overnight rate is now at a level that is expected to keep the Canadian economy on the Bank’s base-case path.

Commentary:

This morning, as 70% of analysts consulted by Bloomberg (including ourselves) were predicting, the Bank of Canada proceeded with another 25 basis point increase in its key interest rates. In line with the last Monetary Policy Report, monetary authorities base their decision on Canada’s vigorous domestic demand and global economic expansion. In addition, the Bank of Canada deems that the evolution by the consumer price index (CPI) and the core index (CPIX) is in line with its projections, in spite of the slight dip by the CPIX seen last week.

However, monetary authorities are pointing out that the overnight rate is now at a level that should keep Canada’s economy near equilibrium, with growth that will, on average, be close to full production capacity (about 3%) and inflation that should return to close to the 2% target. The Bank of Canada thus seems to be saying that the increase ordered today will likely be followed by a pause in the conduct of monetary policy.

This pause is clearly necessary due to the many risks currently affecting the outlook for Canadian economic expansion. These include, for example, the marked appreciation by the loonie and its adverse impact on foreign trade, the existence of sizeable regional disparities in the country, the possibility that the U.S. economy will run out of steam, as well as the recent upward revision to Canadian labour productivity and its impact on the measurement of the economy’s potential.

In the months to come, the Bank of Canada will keep an eye on the evolution of the world and Canadian economies, as well as that of the financial markets. However, if it appears that the economy and inflation are growing faster than Canada’s monetary authorities expected, and are exceeding the conditions for long-term equilibrium, the Bank could potentially reinitiate monetary firming.

Canada: Overnight rate and inflation

Sources: Statistics Canada, Datastream and Desjardins, Economic Studies
BoC Press Release:

OTTAWA—The Bank of Canada today announced that it is raising its target for the overnight rate by one-quarter of one percentage point to 4 1/4 per cent. The operating band for the overnight rate is correspondingly increased, and the Bank Rate is now 4 1/2 per cent.

The strong momentum in the global and Canadian economies has continued, although there has recently been an increased degree of volatility in commodity markets, foreign exchange markets, and financial markets more generally. Recent Canadian data confirm that domestic demand remains solid, and that both CPI and core inflation are evolving largely in line with the Bank’s expectations.

With today’s increase, the target for the overnight rate is now at a level that is expected to keep the Canadian economy on the base-case path projected in the April Monetary Policy Report (MPR) and to return inflation to the 2 per cent target. The Bank will monitor global and domestic economic and financial developments, including adjustments in the Canadian economy, relative to the projection set out in the MPR. The Bank continues to assess the risks to this projection to be as presented in the MPR.