RBC Economics & Thought Leadership

Daily Economic Update

October 26, 2022

BoC's half point hike suggests peak is near

- BoC dials back tightening pace with below-consensus 50 bp hike to 3.75%
- Statements says rates expected to rise further but getting closer to end of tightening phase
- BoC sees economy stalling in coming quarters

The BoC dialed back the pace of its tightening cycle today with a 50 bp increase that fell short of market expectations and consensus for another 75 bp hike. We were in the minority anticipating a half point increase, with a deteriorating global backdrop, slowing domestic growth, early signs of a softening labour market, and faster-than-expected decline in headline inflation all supporting a slower pace of rate hikes. These factors apparently outweighed concerns about a weakening Canadian dollar (ahead of a likely 75 bp hike by the Fed next week), sticky core inflation and only modest improvement in inflation expectations. For all the concerns about the currency, this morning's dovish surprise hasn't had a sustained impact on the Canadian dollar, though government bond yields are down sharply.

With today's smaller-than-expected rate increase, the BoC has entered the late stages of what has been a historically rapid tightening cycle. While we are "not there yet," Governor Macklem made clear that we are getting closer to the end of the BoC's tightening phase. He also said the BoC is "trying to balance the risks of under- and over-tightening," suggesting a more even-handed approach than in recent months. Today's dovish pivot supports our view that the BoC will continue to taper its tightening cycle into year end with a 25 bp increase in December leaving the terminal rate at 4%. Risks around that forecast are still skewed to the upside—indeed, Macklem seemed to frame next meeting's debate as 25 vs. 50 bps—and we think the BoC will want to see further easing in monthly core inflation measures and inflation expectations to pause at 4%.

Justifying what is still an outsized rate increase, the BoC continued to emphasize high and broadly-based inflation and domestic price pressures stemming from excess demand and tight labour market conditions. But at the same time (and consistent with our assessment above) the policy statement noted a challenging global growth backdrop and evidence that policy tightening is slowing domestic activity beyond its early impact on housing. GDP growth is now projected to "essentially stall" in the coming quarters. While the BoC isn't using the r-word, it acknowledged "a couple of quarters with growth slightly below zero is just as likely as a couple of quarters with small positive growth." That might be as close as the central bank will come to calling a recession until we're actually in one. While the BoC cut its 2023 growth forecast in half to 0.9%, that's still well above our 0.2% projection.

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