Economic Update

December 6, 2023

BoC remains on hold, emphasizing weakened economic backdrop

- The Bank of Canada opted to keep the overnight rate unchanged at 5% in its announcement today after also foregoing a hike in each of September and October.
- The option for more tightening was again retained – the governing council "remains prepared to raise the policy rate further if needed." But the dovish undertone with the rest of the statement suggests that option is not expected to be exercised.
- The language around heightened inflationary risks that was added in the October statement was, as expected, dropped. Emphasis was placed on the recent round of weak economic data that undershot prior expectations, seen by the central bank as "further signs that monetary policy is moderating spending and relieving price pressures".
- Data highlighted in the statement included the 1.1% annualized contraction in GDP in Q3 that came in well below BoC's projection in October for a 0.8% increase. Weakening in Labour market conditions, although not officially part of the mandate for the central bank, also received a mention with unemployment in Canada persistently inching higher since spring.
- The BoC's own preferred core inflation measures were still above the 1% to 3% target range at last count, but have shown improvement alongside a narrowing in the breadth of price pressures across the consumer basket.
- Wage growth, persisting at 4-5% year-over-year range as highlighted in the statement today is one of the few corners where growth has yet to have slowed. Residual pressures could be tied to longer-term contract renegotiations that lag past inflation. But continuous softening in labour demand suggests that the strength is unlikely to persist.
- Overall, the central bank judged from recent round of data that the Canadian economy as of the fourth quarter is "no longer in excess demand". That implies that the BoC views economic conditions as now soft enough for inflation to return fully back to the 2% target rate, which is in line with Governor Macklem's comment earlier in October that interest rates are likely already restrictive enough, and "more downward pressure on inflation is in the pipeline".

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- **Bottom Line:** Overall inflationary risks have continued to recede in Canada after dominating the economic landscape for the past two years, and are gradually becoming more equally weighted with downside growth risks. Currently softer trends in consumer spending and labour market data are still consistent with a “mild” economic downturn, and are expected to be extended into early 2024 alongside more easing in inflation pressures. Still, the BoC will be cautioning against pivoting to rate cuts too quickly. Our own forecast is that the BoC will remain on hold until the second half of next year before cutting the overnight rate. Risks are that the move comes earlier if the economic slowdown were to become faster and/or steeper than expected.