Economic Update

March 8, 2023

BoC officially moves to the sidelines

- Overnight rate held at 4.50% as widely expected
- Policy statement reiterates conditional pause
- Market reaction leans dovishdone"

The BoC held its overnight rate steady at 4.50% today after hiking at each of its past eight meetings (425 bps cumulatively). This was easily its least anticipated decision in more than a year with the BoC having clearly signaled a pause in January and set a fairly high bar to resume tightening. Six weeks was simply too little time to see "an accumulation of evidence" in favour of a restart, and in any case data over that period was mixed. That led to a fairly balanced if not slightly dovish policy statement with the BoC reiterating a conditional pause, and maintaining a tightening bias but not sounding inclined to act on it.

The BoC noted disappointing Q4 GDP growth (flat vs. an expected 1.3% annualized increase) but attributed the miss to a significant inventory drawdown. While consumption increased, the statement said restrictive monetary policy is weighing on household spending. Unlike the January statement there was no mention of "excess demand" in the economy, though the labour market "remains very tight." The BoC took note of January's surprisingly strong job gain and still-firm wage growth which is out of line with weak productivity. But overall developments—including further slowing in 3-month measures of core inflation—were seen as in line with the bank's forecast for inflation to slow to 3% (the upper end of its inflation-control target range) by mid-year.

While the BoC has hit pause on its tightening cycle, other central banks (particularly the Fed and ECB) look set to raise rates further than previously expected. Indeed, the statement noted stronger near-term outlooks for growth and inflation in the US and Europe, as well as upside risks to the commodity price outlook from the reopening of China's economy and the war in Ukraine. That has contributed to tightening global financial conditions and a stronger US dollar. There was no direct mention of the Canadian dollar, which on a trade-weighted basis is now at its lowest level since mid-2020. As the market has reassessed terminal fed funds, it has also priced in significant odds of one more hike by the BoC later this year. But today's policy statement did nothing to endorse that view, and the market reaction has been mildly dovish.

Josh Nye | Senior Economist, RBC Economics | Royal Bank of Canada | T. (416) 974-3979

For more economic research, visit our website at *https://thoughtleadership.rbc.com/economics/*