

Bank of Canada raised its policy rate by 0.50%, the seventh consecutive rate hike

Special Edition Canada Outlook | December 2022



Seventh consecutive interest rate hike in the post COVID-19 rate hike cycle, brings policy rate to 4.25%

At its December meeting, the Bank of Canada (BoC) raised its policy rate, from 3.75% to 4.25%, for the seventh time in the post COVID-19 rate hike cycle that started in March. In 2022, the BoC tightened its monetary policy significantly by raising the target interest rate by 400 basis points (bps), the sharpest rate hike cycle in the BoC's history. Heading into this meeting, economists were generally evenly split in terms of a 25bps rate hike versus a 50bps rate hike as economic data did not provide convincing evidence favouring either rate hike pace while the BoC did not provide a clear signal on its policy intention. The financial market was somewhat skewed towards a 25bps rate given the BoC's back-to-back slowdown in the rate hike pace in the previous two meetings and the growing public pressures on slowing down and pausing rate hikes.

Economic growth stronger than expected in Q3. Inflation losing momentum but overall still too high.

Third quarter GDP data showed that economic growth in Canada was stronger than expected compared to the BoC's projection (2.9% versus 1.5%). The economy continued to operate in excess demand and the labour market remained tight, with the unemployment rate near historic lows. Some of the domestic demand, however, showed clear signs of slowdown. Household consumption clearly moderated in Q3 and housing market activity continued to decline significantly after the previous quarters of unsustainable growth. In terms of inflation, data showed that it has finally lost some momentum after running very hot into the summer. Despite the decline in momentum, inflation overall remains too high with the October inflation at 6.9% and core inflation around 5%. The risk that elevated inflation becomes entrenched remains as short-term inflation expectations are still elevated and well above the BoC's 2% target.

Key takeaways:

- A 0.50% rate hike brings the policy rate to 4.25%, well above the BoC's neutral range of 2-3%.
- The Canadian economy remains in excess demand with tight labour markets while some sectors showed clear signs of slowing.
- The BoC softened its forward guidance on interest rates and opens the door for a potential pause at January meeting.

Forward guidance on interest rates softened and a potential pause might be in sight at January meeting

The BoC softened its forward guidance on interest rates at this meeting. It changed the language from "...expecting that the policy interest rate will need to rise further..." to "...considering whether the policy interest rate needs to rise further...". It essentially opens the door for a potential pause in January but stops short of making a firm commitment. This language change is a natural progression from the comments made by Governor Macklem since October when he said "We are getting closer, but we are not there yet." Looking ahead, there is a rich set of data — including two CPI reports, one Labour Force Survey, the quarterly Business Outlook Survey, and the quarterly Canadian Survey on Consumer Expectations — for the BoC to digest before forming a decision at its January meeting.

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Expiry Date: February 28, 2023
DK2200354A