BoC's Macklem Pivots Further on Inflation—January Hike Pricing is Too Light

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- **Governor Macklem "not comfortable" with inflation**
- **His speech downplays flexibility to probe maximum employment…**
- **…given that inflation is far above the BoC's target**
- **Key quotes indicate Macklem is in more of a rush to tighten**

The Bank of Canada's reaction function appears to be rapidly shifting as evidenced by the Governor's remarks today.

Governor Macklem's speech (here) more clearly explained how the BoC sees the somewhat altered inflation agreement with the Federal Government being applied in the current context. There is a hawkish undertone. Markets somewhat got the message by reversing much of the head fake rally in short-term market rates after the inflation figures (recap here), while capping the depreciation in CAD. Those are pretty modest market responses relative to the central message.

The tone of the speech generally reinforced his remarks in Monday's press conference—that now is not the point in the cycle to place emphasis upon targeting maximum employment versus being focused on inflation. His tone indicates that the central bank perhaps nurtures maximum employment when inflation is closer to the 2% target which we are not today. The strong implied message is they're basically ticking the box on the labour recovery and shifting gears toward addressing the inflation mandate—much like the Fed but absent a formal dual mandate.

Here are what I think are the most pertinent quotes. They clearly state that flexibility around probing where maximum employment exists is a luxury when inflation is closer to target and that they don't have that luxury given current conditions as indicated by high inflation. They leave the door wide open to hiking in January pending omicron developments, jobs data, inflation data and broader developments.

> "We are not comfortable with where we are on inflation." The progression of Macklem's thoughts around the issue go somewhat as follows: it's all base effects —> it's transitory —> there is narrow breadth to the price increases —> inflation is short-lived but not transitory —> now he's not comfortable with where inflation is.
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> "Clearly that time is getting closer." In response to being asked whether it is time to move away from forward guidance to look through hot inflation.
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> "I think what you're seeing overall is that the significant amount of slack that we did have in the economy is substantially diminished." [ed. Note the emphasis upon past tense here.]
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> "There is no question slack in the labour market has been absorbed. There are vacancies that continue to indicate demand for labour in the economy."

"We will be watching incoming data very closely. When we get to January 26th at our next decision we will have a full MPR including an updated outlook and updated risks and I assure you we will provide the appropriate amount of stimulus for the economy." This remark can be easily interpreted as a nod to a January hike in my view.

"The agreement also notes that when conditions warrant, the Bank may use the flexibility of the 1 to 3 percent control range to actively seek the maximum level of sustainable employment. When might conditions warrant? When inflation is close to target, interest rates are at more normal levels, and we're not sure if we've really reached maximum sustainable employment. That is not the current situation, of course, since inflation is now already considerably above our target and our policy interest rate is very low. But as we move beyond this pandemic and the economy normalizes, uncertainty about maximum sustainable employment will persist. When conditions warrant, we can probe by being more patient to help us better gauge the level of employment that is consistent with price stability."

"While we expect inflation to ease in the second half of 2022, we are closely watching inflation expectations and wage costs. And we will ensure that the forces pushing up prices do not become embedded in ongoing inflation. Our framework enables us to do just that." [ed this remark implies they are open to jolting expectations lower imo].

"As I have already outlined, price stability and maximum sustainable employment go hand in hand."

"And you can expect to see more discussion from us linking our analysis of labour markets to our monetary policy decisions."

Now, since equilibrium conditions in the economy can exist when overall economic slack is closed and maximum employment is achieved, does the BoC also not have the flexibility to explore exactly when slack is gone? That 'money question' was not asked by the reporters but the tone of Macklem's remarks either indicates he is losing patience with inflation despite measures indicating that slack exists which would mean tossing aside his pledge not to hike before slack is gone, or revisions to potential GDP that bring forward closure of spare capacity.

Onto the Fed!