Scotiabank

GLOBAL ECONOMICS

SCOTIA FLASH

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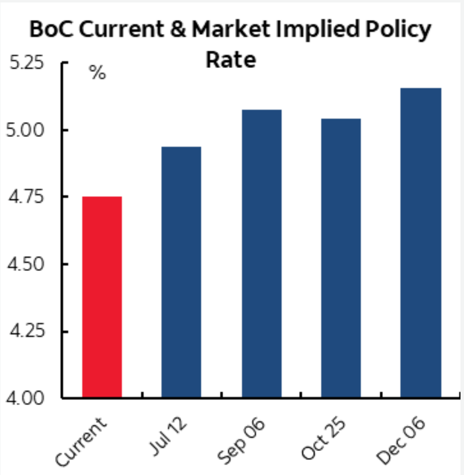
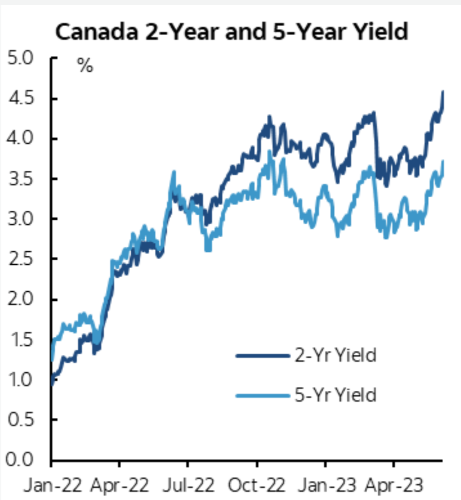
Chart 1



Sources: Scotiabank Economics, Bloomberg.

Chart 2



Sources: Scotiabank Economics, Bloomberg.

Bank of Canada Hikes, Leaves the Door Open for More

- **The BoC raised its overnight rate by 25bps...**
- **...as a minority including Scotia Economics expected**
- **The bias leaves the door open to doing more...**
- **...and tentatively favours another 25bps in July**

The Bank of Canada hiked its overnight rate by 25bps to 4.75% as forecast by Scotia Economics. This was a surprise to markets and so the Canada two-year yield jumped by 21bps post-statement while the C$ appreciated by half a penny at first before reining in some of that reaction because the BoC decision hit US short-term rates. The US two-year yield jumped by 7bps while raising the probability of another Fed hike on the logic that multiple central banks are not done yet. July is priced for another 25bps BoC hike.

Markets had gone up to the 10amET statement pricing less than 50% odds of a hike and only 8 out of the rather generously defined consensus pool of 37 forecasters anticipated the hike. Scotia Economics led all of this consensus with guidance that the front-end was overly dear back in March and April and for months has guided toward renewed hike risk into the summer months. Go Team Scotia, and kudos to the competition for strengthening the quality of the debate with views from all sides. I think the BoC did the right thing and hats off to the Governor and Governing Council for doing what's necessary.

But where to from here? My reading of the statement leaves the door open to doing another 25bps in July, but it's going to be a data dependent call. Today's hike gives them more optionality to decide what to do before going on vacation in August. In coming to this view, the following remarks in the statement are worth emphasizing.

- "....monetary policy was not sufficiently restrictive..."
- "...underlying inflation remains stubbornly high."
- "Overall, excess demand in the economy looks to be more persistent than anticipated."
- "....prices for a broad range of goods and services coming in higher than expected."
- "...with three-month measures of core inflation running in the 3 ½ – 4% range for several months and excess demand persisting, concerns have increased that CPI inflation could get stuck materially above the 2% target."
- they used "surprisingly" to describe strength in US & Canadian consumer spending.
- "Governing Council will continue to assess the dynamics of core inflation and the outlook for CPI inflation. In particular, we will be evaluating whether the evolution of excess demand, inflation expectations, wage growth and corporate pricing behaviour are consistent with achieving the inflation target."

"Stuck"? "Surprisingly"? These are frank words of admission that the BoC realizes it faces more upside risk to growth and inflation than previously judged. The final paragraph's guidance certainly does not slam the door on further policy tightening. It keeps it wide open, depending upon the evolution of data and developments.

Please see the accompanying statement comparison. The next decision lands on July 12th with a full MPR and forecasts. Deputy Governor Beaudry will deliver tomorrow's Economic Progress Report (3:10pmET) followed by a press conference (4:45pmET). The Summary of Deliberations will be published on June 21st. What the BoC also accomplished with a hike today is to disprove the flawed notion that only the Governor can deliver their decisions and that's a very good thing for Governing Council's credibility.

RELEASE DATE: June 7, 2023

The Bank of Canada today increased its target for the overnight rate to 4¾%, with the Bank Rate at 5% and the deposit rate at 4¾%. The Bank is also continuing its policy of quantitative tightening.

Globally, consumer price inflation is coming down, largely reflecting lower energy prices compared to a year ago, but ***underlying inflation remains stubbornly high.*** While economic growth around the world is softening in the face of higher interest rates, major central banks are signalling that interest rates may have to rise further to restore price stability. In the United States, the economy is slowing, although ***consumer spending remains surprisingly resilient*** and the labour market is still tight. Economic growth has essentially stalled in Europe but upward pressure on core prices is persisting. Growth in China is expected to slow after surging in the first quarter. Financial conditions have tightened back to those seen before the bank failures in the United States and Switzerland.

Canada's economy was stronger than expected in the first quarter of 2023, with GDP growth of 3.1%. ***Consumption growth was surprisingly strong and broad-based***, even after accounting for the boost from population gains. Demand for services continued to rebound. In addition, spending on interest-sensitive goods increased and, more recently, housing market activity has picked up. The labour market remains tight: higher immigration and participation rates are expanding the supply of workers but new workers have been quickly hired, reflecting continued strong demand for labour. Overall, excess demand in the economy looks to be more persistent than anticipated.

CPI inflation ticked up in April to 4.4%, the first increase in 10 months, with prices for a broad range of goods and services coming in higher than expected. Goods price inflation increased, despite lower energy costs. Services price inflation remained elevated, reflecting strong demand and a tight labour market. The Bank continues to expect CPI inflation to ease to around 3% in the summer, as lower energy prices feed through and last year's large price gains fall out of the yearly data. ***However, with three-month measures of core inflation running in the 3½-4% range for several months and excess demand persisting, concerns have increased that CPI inflation could get stuck materially above the 2% target.***

Based on the accumulation of evidence, Governing Council decided to increase the policy interest rate, ***reflecting our view that monetary policy was not sufficiently restrictive*** to bring supply and demand back into balance and return inflation sustainably to the 2% target. Quantitative tightening is complementing the restrictive stance of monetary policy and normalizing the Bank's balance sheet. ***Governing Council will continue to assess the dynamics of core inflation and the outlook for CPI inflation. In particular, we will be evaluating whether the evolution of excess demand, inflation expectations, wage growth and corporate pricing behaviour are consistent with achieving the inflation target.*** The Bank remains resolute in its commitment to restoring price stability for Canadians.

RELEASE DATE: April 12, 2023

The Bank of Canada today held its target for the overnight rate at 4½%, with the Bank Rate at 4¾% and the deposit rate at 4½%. The Bank is also continuing its policy of quantitative tightening.

Inflation in many countries is easing in the face of lower energy prices, normalizing global supply chains, and tighter monetary policy. At the same time, labour markets remain tight and measures of core inflation in many advanced economies suggest persistent price pressures, especially for services.

Global economic growth has been stronger than anticipated. Growth in the United States and Europe has surprised on the upside, but is expected to weaken as tighter monetary policy continues to feed through those economies. In the United States, recent stress in the banking sector has tightened credit conditions further. US growth is expected to slow considerably in the coming months, with particular weakness in sectors that are important for Canadian exports. Meanwhile, activity in China's economy has rebounded, particularly in services. Overall, commodity prices are close to their January levels. The Bank's April *Monetary Policy Report* (MPR) projects global growth of 2.6% this year, 2.1% in 2024, and 2.8% in 2025.

In Canada, demand is still exceeding supply and the labour market remains tight. Economic growth in the first quarter looks to be stronger than was projected in January, with a bounce in exports and solid consumption growth. While the Bank's Business Outlook Survey suggests acute labour shortages are starting to ease, wage growth is still elevated relative to productivity growth. Strong population gains are adding to labour supply and supporting employment growth while also boosting aggregate consumption. Housing market activity remains subdued.

As more households renew their mortgages at higher rates and restrictive monetary policy works its way through the economy more broadly, consumption is expected to moderate this year. Softening foreign demand is expected to restrain exports and business investment. Overall, GDP growth is projected to be weak through the remainder of this year before strengthening gradually next year. This implies the economy will move into excess supply in the second half of this year. The Bank now projects Canada's economy to grow by 1.4% this year and 1.3% in 2024 before picking up to 2.5% in 2025.

CPI inflation eased to 5.2% in February, and the Bank's preferred measures of core inflation were just under 5%. The Bank expects CPI inflation to fall quickly to around 3% in the middle of this year and then decline more gradually to the 2% target by the end of 2024. Recent data is reinforcing Governing Council's confidence that inflation will continue to decline in the next few months. However, getting inflation the rest of the way back to 2% could prove to be more difficult because inflation expectations are coming down slowly, service price inflation and wage growth remain elevated, and corporate pricing behaviour has yet to normalize. As it sets monetary policy, Governing Council will be particularly focused on these indicators, and the evolution of core inflation, to gauge the progress of CPI inflation back to target.

In light of its outlook for growth and inflation, Governing Council decided to maintain the policy rate at 4½%. Quantitative tightening continues to complement this restrictive stance. Governing Council continues to assess whether monetary policy is sufficiently restrictive to relieve price pressures and remains prepared to raise the policy rate further if needed to return inflation to the 2% target. The Bank remains resolute in its commitment to restoring price stability for Canadians.