January 25, 2023

BoC rate hiking cycle appears to be over

- Bank of Canada hiked overnight rate by 25 bps to 4.5%, but signaled further increases are not expected
- Positive signs inflation is easing and a slowing economy have increased confidence that interest rates are already high enough
- BoC still ‘data-dependent’ but we expect will now leave the overnight rate unchanged for the rest of this year

The 25 basis point hike was as expected, but the BoC flagged this was probably the last increase to the overnight rate. The BoC flagged stronger-than-expected economic momentum at the end of last year as a reason to go ahead with an additional rate increase to build on the 400 bps of hikes in 2022 - the unemployment rate was still close to record low levels at 5% in December. But the 25 bp increase was still the smallest since March last year.

The BoC now "expects to hold the policy rate at its current level while it assesses the impact of cumulative interest rate increases" to date. It takes time for Interest rate increases work their way through the economy. While recent economic data has been firmer-than-expected, the lagged impact of the aggressive interest rate increases in 2022 are expected to slow consumer spending and business investment in the year ahead. The household debt service ratio will likely hit record levels this year, in large part as households renew mortgages at higher interest rates. Inflation is still running well above target, but lower commodity prices and slower growth in the 3-month average ‘core’ CPI measures were again highlighted as reasons to think that price growth will continue to slow (broadly in line with our own tracking of recent inflation developments.)

With inflation still running very hot, Governor Macklem confirmed that the central bank is more concerned about upside than downside risks to inflation. The pause in interest rate increases is conditional on the outlook evolving as expected and inflation pressures continuing to ease. Still, our GDP forecasts are slightly weaker than the BoC’s projections - we expect a ‘moderate’ recession and higher unemployment this year - so we don’t expect they’ll need to restart. Odds are that this was the last interest rate increase of this hiking cycle and we look for the BoC to now leave the overnight rate at the current 4.5% level for the rest of this year.