RBC Economics & Thought Leadership

Economic Update

July 12, 2023

Bank of Canada 'data dependent' after July rate hike

- The Bank of Canada hiked the overnight rate by 25 basis points for the second straight meeting after ending a short pause that began earlier this year in June. That takes the overnight rate to 5%, the highest since 2001.
- The hike was widely expected - it was highly unlikely that the BoC ended its pause last month for just the one additional 25 basis point increase in June. And consumer spending since was too resilient and underlying inflation trends too persistent to prevent another hike today.
- The policy statement sounds decidedly hawkish, leaving the door open for more rate hikes this year. Macklem in the press conference later maintained that the bank will remain on a data-dependent, meeting-by-meeting approach when it comes to decisions beyond July.
- The BoC highlighted that interest rates are having an impact on consumer spending, but that households appear to be more resilient to higher interest rates than previously expected thanks to a tight labour market, elevated wage growth, and large stockpile of pandemic savings.
- The Monetary Policy Report showed higher GDP growth forecasts for this year. Medium inflation expectations were also revised higher – CPI is not expected to return to 2% until mid-2025. Those changes are in line with the persistent excess demand in the economy the BoC emphasized.
- Monthly increases in the BoC's preferred core inflation measures has also slowed, but have been sticky at still above the top end of the 1% to 3% inflation target range. Focus will remain on those more recent price growth rates in the near-term as energy price 'base-effects' continue to push headline inflation growth lower.
- **Bottom line:** Governor Macklem reiterated in today's press conference the BoC will need to increasingly balance the risk between over and under-hiking. Our own outlook is a more pessimistic one than the central bank's. We see more signs that the economic backdrop is softening as the unemployment rate edges higher, inflation expectations trend lower and intensity of labour shortages ease (according to the last Business Outlook Survey). That should be enough to push the BoC back on the sidelines with no additional interest rate increases this year. But they are clearly willing to hike again at the next decision in September if inflation in particular doesn't show further signs of easing.

Nathan Janzen | Assistant Chief Economist, RBC Economics | Royal Bank of Canada | T. (416) 974-0569

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