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Bank of Canada raised its policy rate by 0.25% and signalled a conditional pause

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Eighth consecutive interest rate hike in the post COVID-19 rate hike cycle, brings policy rate to 4.50%

At its January meeting, the Bank of Canada (BoC) raised its policy rate. by 25 basis points (bps) from 4.25% to 4.50%. This is the eighth rate hike in the post COVID-19 hiking cycle that started in March 2022. The BoC has tightened its monetary policy significantly over the last 12 months by raising the target interest rate by a cumulative 425 bps, the sharpest rate hike cycle in the BoC's history. Since December 2022, economists have gradually raised their forecast for the interest rate level because they had previously underestimated the degree of excess demand and inflationary pressures in the Canadian economy. Into this decision, the BoC, as expected, raised its policy rate by 25bps to 4.50% and indicated a conditional pause after this rate hike.

Economic growth is slowing but was stronger than expected in H2. The overheated Canadian economy did not cool as much as expected with inflation overall remaining too high.

The Canadian economy slowed in the second half of 2022 but did not cool as much as the BoC expected. Q3 and Q4 GDP were 2.9% and 1.3%, respectively, compared to the BoC's projections of 1.5% and 0.5%. The labour market remained tight with strong jobs gains, a near record low unemployment rate, and elevated job vacancies. Overall, the Canadian economy remained overheated with excess demand persisting. Inflation, on the other hand, has declined to 6.3% year-on-year, driven primarily by lower energy prices and improved supply chain conditions. But it is still too high, especially with both core inflation measures and near-term inflation expectations still elevated. Amid stronger than expected growth and elevated inflation, the BoC

Key takeaways:

- A 0.25% rate hike brings the policy rate to 4.50%, well above the BoC's neutral range of 2-3%.
- The Canadian economy slowed, but was stronger than the BoC's projection. The economy remains in excess demand with tight labour markets.
- The BoC changed its forward guidance on interest rates and enters a conditional pause for rate hikes in future meetings.

concluded at this meeting that a modest increase in the policy rate is still needed.

Forward guidance on interest rates changed to a conditional pause for future decisions, while the tightening bias remains

In terms of forward guidance on interest rates, the BoC will now enter a conditional pause in its future meetings to assess the cumulative effect of the 425 bp interest rate increase and whether this monetary policy setting is sufficiently restrictive to bring inflation back to the 2% target. In other words, if economic developments evolve broadly in line with the BoC's forecast, then it expects to hold the policy rate at this current level. If not, the BoC will recalibrate the policy rate higher. In addition, this conditional pause does not change the BoC's tightening bias. The BoC remains concerned about the upside risks in inflation and is prepared to raise rates further if upside risks materialize. Lastly, the BoC indicated it is still too early to discuss rate cuts.

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