

# Bank of Canada raised its policy rate by 0.50%, the sixth consecutive rate hike

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## The sixth consecutive interest rate hike in the post COVID-19 rate hike cycle, bringing the policy rate well above the Bank's neutral range of 2-3%

At its October meeting, the Bank of Canada (BoC) raised its policy rate for the sixth time in the post COVID-19 rate hike cycle that started in March. The BoC raised its policy rate from 3.25% to 3.75% at this meeting. This 0.50% rate hike is a step-down from the 0.75% rate hike in September which was a step-down from the 1% rate hike in July. This rate hike surprised the market and the majority of economists as a 0.75% rate hike had become widely expected into the meeting after a speech by Governor Tiff Macklem in early October that shaped market expectations together with the September CPI reading. This slow-down in pace and smaller than expected rate hike is a meaningful step by the Bank towards pivoting from an on-going rate hike stance to a meeting-by-meeting decision stance.

## Headline inflation eased but underlying inflation pressures are broad-based and have not shown signs of easing

Since the September BoC interest rate decision, headline CPI inflation eased from 7.6% to 6.9%. The easing was driven by the decline in gasoline prices. Although headline inflation had eased, inflationary pressures remained broad-based with two-thirds of CPI components increasing more than 5% over the past year. Inflation, excluding food and energy, and BoC's core inflation measures are all around 5% and are not yet showing meaningful evidence that underlying price pressures are easing. These elevated inflationary pressures reflect excess demand in the Canadian economy and tight labour markets with almost one million job vacancies.

### Key takeaways:

- A 0.50% rate hike following a 0.75% rate hike in September, bringing the policy rate well above the BoC's neutral range of 2-3% to restrain excess demand and dampen elevated inflation.
- The BoC scaled down its rate hike pace to balance the risks of under- and over-tightening amid slowing growth.
- The policy rate will still need to rise further to return inflation to the 2% target but this rate hike cycle is closer to the end after this rate hike.

## **This 0.50% rate hike balances the risks of under- and over-tightening amid slowing growth**

Based on the current projection by the Bank, Canada's GDP growth is expected to stall through the end of this year and the first half of 2023. Amid this slow down to a stalling speed, for the first time since the start of this rate hike cycle, the Bank explicitly turned very mindful on the risks of higher interest rates to the Canadian economy and wanted to balance the risks of under-tightening that might fail to reduce inflation to target and the risks of over tightening that might have harmful consequences for people's ability to service their debts, for their jobs, and for their businesses. As a result, the Bank decided to scale down its rate hike pace to 0.50% in this decision after raising the policy rate by 0.75% and 1% respectively over the last two decisions in September and July.

## **The policy rate will need to rise further but this rate hike cycle is getting closer to the end**

At the conclusion of this decision, the BoC expects that the policy interest rate will need to rise further given elevated inflation and inflation expectations. But as a significant amount of rate hikes took place since March, together with quantitative tightening complementing increases in the policy rate, tighter monetary policy is working through the economy. The BoC signalled this rate hike cycle is getting closer to the end although it is not there yet. Thus, looking ahead to the December BoC decision, the Bank is still expected to raise its policy rate further and the pace is currently expected to be more towards a 0.25% hike.

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