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BoC holds rates steady with talks shifting to timing of cuts

- The Bank of Canada held the overnight rate unchanged for a fourth consecutive meeting, extending a pause that started after the last hike in July last year.
- The BoC is still concerned about inflation risks but the explicit statement that the BoC "remains prepared to raise the policy rate further if needed" from earlier decisions was dropped. Governor Macklem confirmed that the focus of discussions at the BoC have shifted from whether interest rates are high enough to how long until they can begin to be lowered.
- Core measures of inflation are not yet showing the "sustained declines" that would allow for the central bank to shift immediately to interest rate cuts. Wage growth is also still running at historically high levels and a pullback in term bond yields (in anticipation of future rate cuts in both Canada and abroad) have already eased financial conditions somewhat from the BoC's last rate decision.
- But a softening economic backdrop makes it increasingly likely that inflation will drift lower rather than higher. The unchanged GDP the BoC expects in Q4 would mark a sixth straight drop in per-capita output. And the unemployment rate has edged higher with increased employment counts no longer keeping up with surging population growth.
- The BoC's estimate of the economy wide output gap in Q4 (a key driver of inflation in the BoC's policy framework) was estimated to be back below zero by the end of last year. That is reinforcing the view among policymakers that inflation will continue to gradually slow.
- **Bottom line:** Interest rates are already at levels that are high enough to restrict economic activity and wobbly-looking GDP growth and labour market backdrops mean the most likely trajectory for inflation going forward is still lower. 'Core' inflation measures have not yet shown the 'sustained' downward pressure towards the 2% target rate the BoC wants to see before pivoting to interest rate cuts. But we expect slower price growth alongside a weakening economic backdrop will push the BoC to start gradually lowering the policy rate late by mid-year.

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