BANK OF CANADA
BANQUE DU CANADA

Summary of Governing Council deliberations: Fixed announcement date of December 11, 2024

December 23, 2024

This is an account of the deliberations of the Bank of Canada's Governing Council leading to the **monetary policy decision on December 11, 2024**.

This summary reflects discussions and deliberations by members of **Governing Council** in stage three of the Bank's **monetary policy decision-making process**. This stage takes place after members have received all staff briefings and recommendations.

Governing Council's policy decision-making meetings began on December 6, 2024. The Governor presided over these meetings. Members in attendance were Governor Tiff Macklem, Senior Deputy Governor Carolyn Rogers and Deputy Governors Toni Gravelle, Sharon Kozicki, Nicolas Vincent and Rhys Mendes.

International economy

Governing Council members began their deliberations by discussing how the global economy had evolved since the October ***Monetary Policy Report***. Their discussion focused primarily on recent economic developments in the United States.

The US economy continued to grow strongly, driven by robust consumer spending. Although unemployment ticked up, the labour market remained solid with strong wage growth. Given the strength in productivity, the impact of strong wage growth on unit labour costs, and hence inflation, had been muted. The recent evolution of economic activity and inflation was broadly in line with expectations. Inflation pressures remained, particularly in services, which had kept inflation steady at around 2½%. While members continued to expect overall inflation to ease gradually in the coming months as supply and demand rebalanced, they highlighted upside risks to this outlook, including from possible policy decisions by the incoming US administration.

In China, recent policy measures and ongoing strength in exports has supported growth. Nevertheless, household spending was still weak, largely because of ongoing challenges associated with the residential property sector. These underlying issues, coupled with uncertainty around potential new US tariffs, were expected to weigh on growth.

Recent indicators suggest growth in the euro area could be weaker than expected, due in part to challenges in the manufacturing sector. Unemployment remained low in the region, but job vacancies had declined. Wage pressures remained and appeared to be feeding into services price inflation.

Global financial conditions had eased since October. Corporate credit spreads continued to narrow and equity markets remained strong. The US dollar had strengthened against most other currencies, including the Canadian dollar, which had depreciated to about 71 cents since October. Compared with most other major currencies, the Canadian dollar was relatively stable.

Canadian economy and inflation outlook

Governing Council members then discussed recent data on economic activity and inflation in Canada. They acknowledged that recent data were mixed. (On one hand, there were encouraging indications that monetary policy easing had begun to translate to higher household spending. On the other hand, overall growth was weaker than expected and the labour market had continued to soften.) Members discussed the mixed data in some detail and assessed the implications for the economic outlook.

National Accounts data for the third quarter showed the economy grew at 1%. This was lower than expected in the October Report. But there were clear areas of strength. Members noted that consumption grew by almost 3½%, surpassing expectations. Consumption per capita rose by 0.6% in the third quarter after declining in six of the last eight quarters.

Retail sales were also stronger than expected in September, thanks in part to a boost in motor vehicle sales. This momentum appears to be continuing into the fourth quarter. Housing resale activity also picked up across the country. Members noted that lower interest rates, combined with new mortgage rules coming into force in December, could be expected to further increase housing market activity.

Other components of the third-quarter data were weak. Business investment was considerably weaker than anticipated and contracted by about 7½%. The drop was mainly driven by a large pullback in investment in manufacturing and equipment, in part due to volatility in the aircraft and transportation equipment subcomponent. Members expressed concern that the uncertainty created by the incoming US administration's threat to impose tariffs on Canadian exports would weigh on the investment climate. Exports also declined in the third quarter, although energy exports were up due to increased shipments through the Trans Mountain Expansion pipeline.

Historical revisions to the National Accounts data showed the level of gross domestic product (GDP) was more than 1% higher than previously reported. Upward revisions were broad-based across GDP components, with consumption and investment the biggest contributors.

Members discussed the recent changes to immigration targets. They agreed that the planned reductions in immigration will translate into lower GDP growth than the Bank had forecast in the October Report, with lower aggregate consumption and less demand for housing. Outreach with small businesses and other regional intelligence suggested the adjustment to sharply lower immigration levels could be difficult for companies that have had challenges recruiting and retaining workers. More broadly, lower population growth would affect both supply and demand in the economy, suggesting less impact on the inflation outlook. Members agreed that further analysis would be needed to assess the likely timing of the demand and supply effects of new immigration targets as part of the preparation of the updated forecast in January.

Labour Force Survey (LFS) data from November showed an increase in employment, but it continued to grow more slowly than the labour force. In November, the participation rate increased significantly, which led to an increase in the unemployment rate to 6.8%. Wage growth also declined in the November LFS survey, but was still elevated relative to productivity growth. Members were cautious about putting too much weight on one month of data, but they agreed that slack in the labour market had continued to increase.

Consumer price index (CPI) data for October indicated that inflation had been evolving in line with expectations. After dropping to 1.6% in September, total CPI inflation rose to 2.0% in October, largely due to less prominent base-year effects from gasoline. Members largely attributed the recent uptick in core measures of inflation to recent volatility in certain goods and services prices. Recent policy measures, particularly the temporary suspension of the GST on some items, could cause short-term volatility in inflation. Members agreed they needed to look through the temporary effects of these measures and focus on the trend of underlying inflation.

Members noted that downward pressure on inflation from goods prices had moderated as these were no longer declining overall. Upward pressure from elevated services price inflation had also moderated, including slower increases in rent and mortgage interest costs. Members agreed that the opposing forces pushing inflation down and pulling it up had both been moderating constructively. Members expected this dynamic to continue in the months ahead and keep inflation close to the target, but there were risks on both sides.

Governing Council members reflected on these upside and downside risks to the inflation outlook. Upward pressure on services prices could resume if wage growth remained elevated relative to productivity. A bigger-than-expected pickup in the housing market could also push shelter costs higher. On the downside, inflation could fall below target if slower growth leads to more sustained slack in the economy.

In addition to these risks, a major new source of uncertainty was the possibility that the incoming US administration would impose tariffs on Canadian exports to the United States. The impact on economic activity and inflation would depend on several factors, including the scope and size of the tariffs and any retaliatory measures that are taken, all of which are impossible to predict. Members acknowledged that the increased uncertainty could already be affecting the outlook, particularly for business investment, but it was not possible to assess the broader implications without more information.

Based on new data since October, members were generally more confident in the recovery in per capita spending and housing. But they agreed that the overall growth outlook was now softer than in October. Recent inflation was largely aligned with expectations, but if growth did not pick up, there could be more downside risk to the inflation outlook.

Considerations for monetary policy

Governing Council members discussed several key factors they were considering as they weighed the current stance and path of monetary policy.

First, on the degree of slack in the economy, members noted new information was mixed. Recent revisions to the National Accounts data showing a higher level of GDP suggested higher potential output, but still somewhat less excess supply in the economy. Yet at the same time, labour market slack was increasing as the growth of the labour force continued to outpace job creation. Governing Council members also discussed the implications of lower immigration on the evolution of economic slack. In principle, lower immigration subtracts from both demand and supply, but the demand effects may be stronger than the supply impact in the near term. Members agreed that further analysis was needed to assess the net impact of new information, but that, overall, the economy remained in excess supply.

Members then discussed the neutral interest rate and the stance of monetary policy. The neutral rate is not observable and is subject to considerable uncertainty. Still, there was agreement that the Bank's current range of 2¼% to 3¼% encompassed the range of views across Governing Council. Members agreed that a policy rate of 3¾% meant that monetary policy remained restrictive.

Governing Council members also deliberated on the implications of the recent depreciation of the Canadian dollar on inflation. A lower exchange rate makes Canadian exports more attractive in the United States, adding to demand. It also makes imports more expensive, which could feed through to inflation in consumer goods and higher costs of production inputs. Members viewed the recent depreciation as largely reflecting US dollar strength across a wide range of currencies, but acknowledged the divergence between US and Canadian monetary policy was likely having some impact.

Overall, while the data were mixed and the outlook was clouded by increased uncertainty, Governing Council members concluded that with inflation on target, economic growth weaker than expected and excess supply in the economy continuing to build, a further reduction in the policy interest rate was needed.

Policy decision

Governing Council members' discussions focused on whether a 50 basis point cut or a 25 basis point cut was more appropriate at this decision.

At the outset, each member of Governing Council acknowledged that the decision was a close call based on their own assessments of the data and the outlook for growth and inflation. Data since the last decision were mixed, with more evidence that household spending was picking up but with a weaker outlook for growth overall.

Members discussed arguments in favour of a 25 basis point cut given that consumption and housing activity were showing signs of strengthening. Some members suggested that policy could be patient while the full effects of past interest rate cuts became clearer. They acknowledged that it may be necessary to do a larger cut in the future if growth did not pick up. However, since the economy was not weakening quickly, there was an opportunity to cut by 25 basis points and gather more information.

Members also discussed arguments supporting a 50 basis point cut in light of the weaker growth outlook and concern about downside risks to the inflation forecast. Some members suggested a 50 basis point cut was appropriate now to ensure monetary policy was no longer clearly in restrictive territory. They acknowledged that not all the recent data pointed to the need for a 50 basis point cut at the present meeting. However, it seemed unlikely that a cut of 50 basis points would take rates lower than they needed to go over the next couple of meetings.

Throughout the discussion, members' views of the merits and risks associated with each option evolved. The discussion coalesced around a consensus decision to cut the policy rate by 50 basis points. Governing Council's decision reflected two important factors:

- First, with inflation at 2% and the economy in excess supply, monetary policy no longer needed to be clearly restrictive.
- Second, the outlook for growth was lower than expected in October, and stronger growth was needed to take up the slack in the economy and keep inflation close to the 2% target.

Governing Council members also discussed the future path for interest rates. There was a range of views on how much further the policy rate would need to be reduced, and over what period that should happen. They agreed that with a further 50 basis point cut at this meeting, the cumulative reduction in the policy rate since June was substantial. The effects of those cuts would be working their way through the economy.

Members agreed that they would likely be considering further reductions in the policy rate at future meetings, and they would take each decision one meeting at a time. They also agreed that given the substantial cuts already in place and based on how they see the outlook, they expected a more gradual approach to monetary policy going forward.

Finally, Governing Council agreed to continue its policy of normalizing the balance sheet by allowing maturing bonds to roll off.

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