



And you thought the BoC had it tough...

By Warren Lovely

The conduct of monetary policy is becoming a delicate balancing act, as rapidly weakening growth (owing to earlier rate hikes, among other things) collides with still-elevated consumer price inflation. Few central banks have it easy, it seems. Just consider the rather bizarre relationship between growth and inflation likely to prevail in 2023. No longer does slow(er) economic growth assure one of well-behaved inflation (Chart 1).

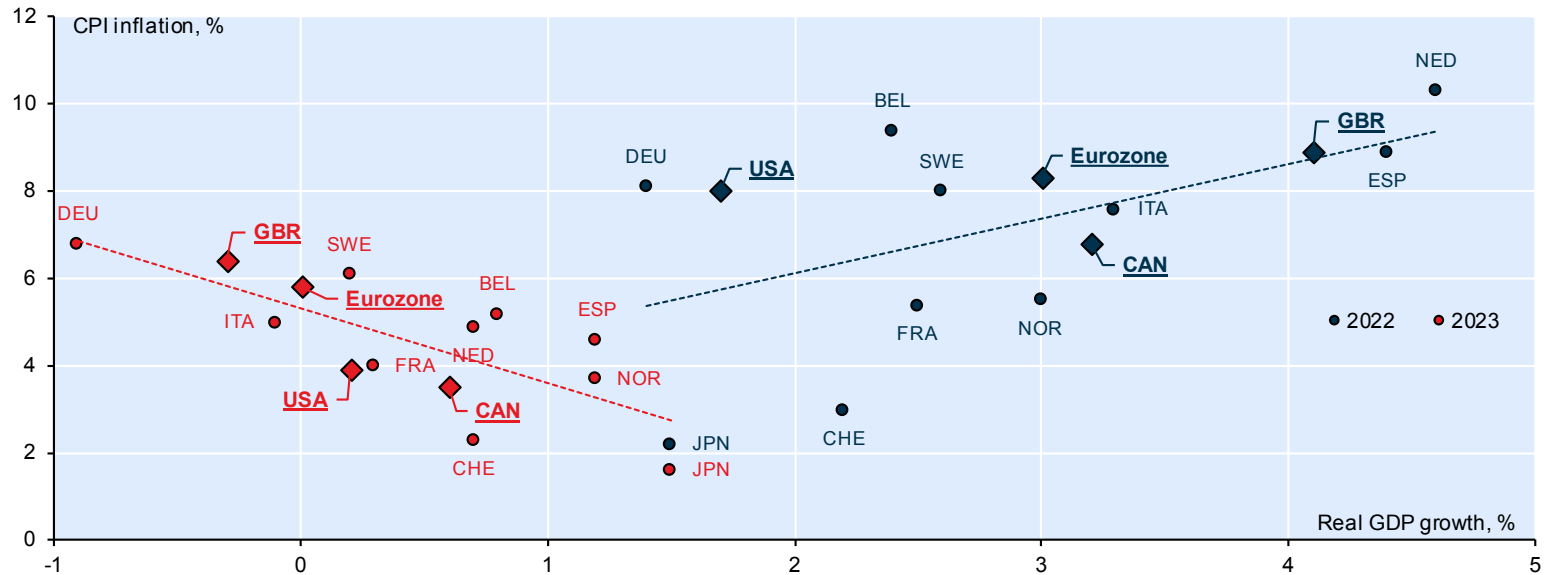
The Bank of Canada did its level best to balance these conflicting forces yesterday, opting for a smaller-than-expected (though not really small) 50-bp interest rate hike. BoC policymaking (and official communications) look and feel a bit tortured at the moment, but Tiff Macklem and the rest of his Governing Council could have it a lot worse... they could be setting monetary policy in Europe!

First, if you thought Canada was characterized by regional (i.e., provincial) divergence, just look at the economic disparities in the Eurozone, where the absolute and relative dispersion in growth and inflation is much more intense (Chart 2). Surely, pronounced differences in economic conditions makes life tougher for a monetary authority. And it's across the pond where economies are headed for a hard(er) landing. The U.K. is poised for contraction next year and it won't be much better in the Eurozone (on average). Problematically, Europe's economic downshift might not deliver meaningful inflation relief, owing to a structurally lower potential growth rate and more direct fallout from the war in Ukraine.

As painful as it may be, at least Canada's looming economic "stall" (to use the BoC's terminology) will leave us with materially slower CPI inflation before 2023 is out. Canadian inflation might even recede faster than the BoC currently forecasts. As for the Fed, it might well benefit from the most efficient/responsive growth-inflation dynamic out there. We believe that will pave the way for the all-important Fed policy pivot sometime around the turn of the year, even if still-lofty core PCE inflation leave Powell & Co. acting and talking tough next week. No one is saying your jobs are easy Messrs. Macklem and Powell, but Ms. Lagarde and Mr. Bailey would surely trade places with you.

Chart 1: The growth-inflation dynamic breaks down, making life tough for central bankers (particularly in Europe)

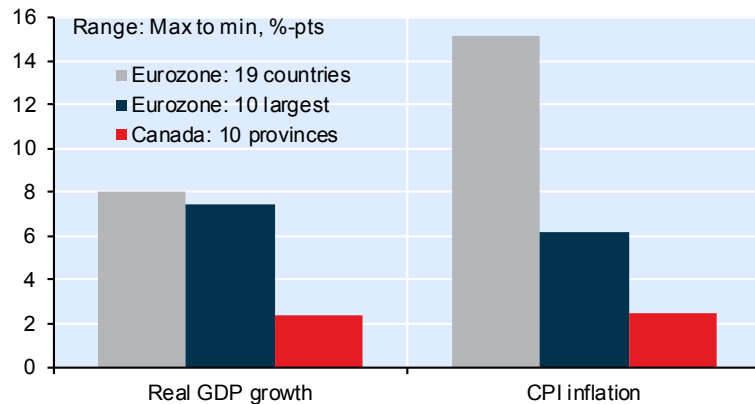
Relationship between real GDP growth & CPI inflation in select advanced economies (2022 & 2023)



Source: NBF, Consensus Economics (Oct-22 fcst) | Note: Eurozone is average of 19 countries, only the largest of which are shown in chart

Chart 2: Greater divergence across Eurozone vs. Canada

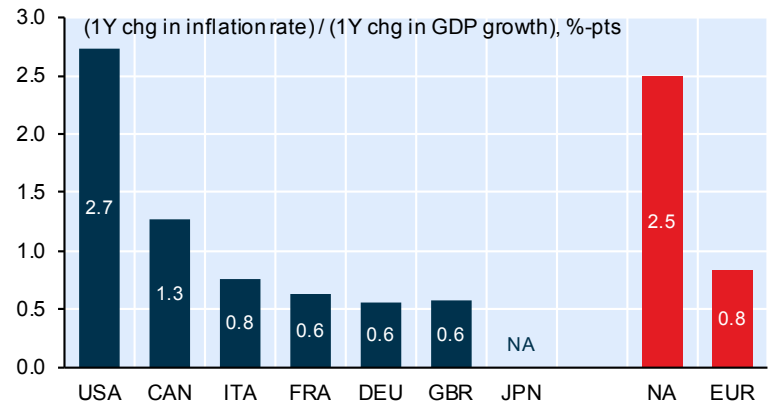
Range of real GDP growth & CPI inflation: Cdn provinces vs. Eurozone (2022)



Source: NBF (Oct-22 MEM), IMF (Oct-22 WEO) | Note: Based on estimates for 2022

Chart 3: Slower growth = CPI relief in NA, less so in Eurozone

Change in CPI inflation relative to change in real GDP growth (2023 vs. 2022)



Source: NBF, Consensus Economics (Oct-22 fcst) | Note: JPN N/A as growth fcst unchg'd



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