Bank of Canada Rate Announcement

April 10 2024

Bank of Canada holds again, economy proving stronger than expected

There was no surprise in today's rate decision as the Bank of Canada kept its policy rate unchanged at 5.0 per cent and maintained its quantitative tightening path. While laying the conditions for a future cut- namely sustained downward momentum in CPI and core CPI inflation- and highlighting a moderating labour market, the statement and accompanying Monetary Policy Report (MPR) also laid out a rosier view of Canadian and global economic conditions. While inflation has fallen faster than the Bank's previous outlook, strength in the economy could dampen the pace of future rate reductions. Moreover, an upward revision to the neutral rate limits some of the downside on future rates and bond yields.

The Bank's statement and MPR delved deep into the resilience of the broader economy. Specifically, it highlighted the U.S. economy which remains buoyed by consumer demand and business investment. Moreover, the weak links of the economy, including Europe is anticipated to recover. The global economic outlook is expected to be stronger than previously forecast with 2024 revised up from 2.5 per cent to 2.8 per cent this year, and to 3.0 per cent in 2025 from 2.7 per cent. Strength accelerates further to 3.1 per cent in 2026. The key driver is the U.S. which has proven resilience to high interest rates. Growth down south is pegged one point higher than previously expected at 2.7 per cent this year and revised up next year to 1.8 per cent. The U.S. is seeing robust growth in both consumption and investment, the latter of which is driving productivity. China was also nudge higher. Broadly, global inflation continues to ease, but future U.S. declines are anticipated to be uneven and driven by services. Inflation in the U.S. is forecast to reach the Fed's target in 2025.

In Canada, the backdrop was more mixed. Forecasts for growth were revised up to 1.5 per cent this year from 0.8 per cent, albeit with a downward revision in 2022 to 2.2 per cent (from 2.4 per cent). Stronger consumption, government spending housing and exports are drivers. This is led by population growth and impact of completion and shipments from the Trans Mountain Expansion Project. However, with much of this capacity driven growth excess supply is (estimated at -0.5 to -1.5 per cent in H1 2024), this may not be inflationary. Potential output growth was revised higher to 2.5 per cent this year due in part to global and domestic factors such as population growth, albeit slowing in 2025 and 2026. Excess supply is expected to be absorbed in 2025 and 2026.

Excess supply in the economy continues to be observed in an easing labour market, with conditions including the 6.1 per cent unemployment rate in March. Signs of moderating wage pressures were highlighted, and vacancies are back to pre-pandemic levels.

The Bank's inflation outlook came in lower for 2024 than the previous MPR owing in large part to soft numbers early in the year. Q1 is pegged at 2.8 per cent (from 3.2 per cent), although progress slows, with 2.9 per cent y/y forecast for Q2. That said, the trend is falling, and the Bank of Canada noted that breadth of inflation has eased, although shelter remains hot. The annualized 3-month trend has fallen from a 3.5 per cent pace to 3.0 per cent. Q4 CPI inflation is forecast at 2.2 per cent (down from prior forecast of 2.4 per cent). Inflation is forecast to hold at 2.1 per cent at the end of 2025.

While holding steady as expected, our view is that today's statement and MPR is in line with a Bank of Canada cut as early as June. More progress on inflation is required, which will be contingent on further moderation in CPI trends going forward, and sustained easing of wage growth. We could see a delay if this does not occur.

U.S. inflation and economic trends will play a significant role in how fast and deep Canada can cut. While the Bank is likely to move ahead of the Fed, wider deviation could put more pressure on the Loonie and stoke import price inflation. With the neutral moved higher by 25 bps to 2.25 to 3.25 per cent curbs some of the downside for fixed rates and the terminal policy rate.

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