Bank of Canada Rate Announcement

July 24 2024

central 1 Economics

Bank of Canada Rate Announcement: Two down and more to come

The Bank of Canada made it two in a row today, cutting its policy rate for a second consecutive meeting to reduce the target for the overnight rate to 4.50 per cent from 4.75 per cent while continuing its balance sheet normalization policy (quantitative tightening). The cut pushed the policy rate to the lowest level since June of last year. The Bank cited easing inflation and expectation of further declines as driving the decision.

Today's decision to cut was consistent with our call, and that of broader market consensus which had raised the odds of reduction following a cascade of recent data which showed decelerating inflation, slack in the labour market and underperforming economy. The Bank's own Business Outlook Survey pointed to a downbeat outlook from firms.

The Bank of Canada's statement highlighted these themes in its decision and communique. While the Bank noted that economic growth rose by about 1.5 per cent in H1, much stronger population growth of 3 per cent, which further added to excess supply. Household consumption has weakened. The inability to absorb newcomers has lifted the unemployment rate and lengthened the duration of job search. Wage growth, while still high, is showing moderation signs.

On inflation, the Bank highlighted easing pressures in headline and core inflation, while breadth of price increases by component is closer to historical norms. That said, shelter is was the biggest driver of inflation, while wage driven services costs were also higher. Its forecast is for inflation to settle to about 2.5 per cent in the back half of this year and ease through 2025.

The statement coincided with the Bank's Monetary Policy Report or outlook report which points to mixed conditions and a moderate growth environment going forward. On a global basis, the Bank expects modest expansion of 3 per cent through 2026. The U.S. economy is showing signs of slowing, while the euro area and China are growing. Inflation is forecast to decline.

Canada's outlook is for growth of 1.2 per cent this year, followed by a 2.1 per cent expansion in 2025 and 2.4 per cent in 2026. Rising trends are anticipated in the back half of this year in spending and business investment driven by lower borrowing costs, albeit slower population growth is a drag in 2025.

Going forward, more cuts are likely to come although as the Bank noted “Monetary policy decisions will be guided by incoming information and our assessment of their implications for the inflation outlook.” That said, the Bank's views excess supply as lowering inflation pressures, which opens the door to sustained cuts. While shelter costs are elevated, they are in part driven by elevated policy rates or outside its span of control given population driven demand and insufficient housing supply.

Monetary Policy Report Highlights:

Accompanying the Bank of Canada's statement was the Monetary Policy Report which provides the Bank's economic outlook. The report is released four times a year.

Global growth: Growth remained consistent with April's MPR near three per cent through 2026, albeit nudged up for 2024. U.S. growth was revised lower for 2024, from 2.7 per cent to 2.3 per cent, reflecting slowing consumer activity amidst higher interest rate pass through. Growth settles near two per cent. U.S. inflation is still elevated above the Fed target but expected to ease. Euro area growth is picking up and expected to average near 1.5 per cent, while China averages about 4.3 per cent.

Canada economy: The Canadian economy is forecast to grow at 1.5 per cent in Q2 and 2.8 per cent in Q3, annualized. Recent growth has been held back by consumption and residential investment. Annual GDP is forecast to grow 1.2 per cent this year, 2.1 per cent in 2025 and 2.4 per cent in 2026. 2024 was revised lower with higher projections for 2025 and 2026 with stronger exports and business investment in the latter years. With growth driven by population growth in per capita GDP continues declining until 2025, increasing slack in the economy. In the second quarter of 2024, the output gap is estimated to be between -0.75% and -1.75%.

Growth in potential GDP slows in 2025 and 2026 and excess supply is absorbed by the economy.

Canada inflation: Inflation is forecast to slow through the second half of 2024, falling to 2.3 per cent in Q3 and 2.0 per cent in Q4. At the end of 2025 and 2026 y/y inflation sits at 2.0 per cent. The Bank forecasts 2.5 per cent inflation in H1 2025 due to fading base year effects of gasoline. Shelter inflation remains elevated but eases. Inflation is forecast to sustainably return to target by mid-2025.

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