Bank of Canada Rate Announcement

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Economics

Bank cuts for a third straight meeting, economic slack to usher in more reductions

There was no surprise today as the Bank of Canada maintained its monetary easing path with a third straight ¼ point reduction to the target for the overnight rate, leaving it 4.25 per cent, while continuing it quantitative tightening path. The Bank's move was aligned with market expectations and reflected the combination of easing inflation and softening economic conditions.

There was little direction provided by the statement itself, which highlighted mixed global and domestic conditions. U.S. growth has remained firm even as the labour market has softened, while the Euro area economy has been moderate, and China's economy is weakening. Financial conditions have eased.

The Canadian commentary was mixed with the Bank noting the strong Q2 growth rate (2.1 per cent), but highlighted softening in more recent conditions. Specifically, "the labour market continues to slow", albeit with wage conditions still elevated and inflationary given productivity. There are still some concerns about wage growth and stickiness. Inflation continued to moderate, including moderation to 2.5 per cent in July and normalization of share of components with growth above 3 per cent. The Bank stated that *"Excess supply in the economy continues to put downward pressure on inflation, while price increases in shelter and some other services are holding inflation up."*

While the statement was neutral there, the opening statement of the press conference provided more context and signaled further cuts in the months ahead as the focus pivots away from inflation directly and towards the economy and labour market.

Specifically, Governor Macklem noted that there was downward pressure on inflation from excess supply in the economy and provided inflation moves lower as expected, *"it is reasonable to expect further cuts in our policy rate."* Moreover, downside risks have also increased. Macklem noted that there was downside risk to Q3 growth given recent patterns which is in line with our view, and the labour market is weakening which should slow wage growth. Finally, with the statement *"At the same time, with inflation getting closer to the target, we need to increasingly guard against the risk that the economy is too weak, and inflation falls too much"* suggests the potential for deeper or faster cuts.

We remain of the view that the Bank will cut the policy rate by ¼ point at each of the remaining two meetings and end the year at 3.75 per cent. The cadence of reductions will be more moderate, but we anticipate a rate of 2.75 per cent by the third quarter of 2025.

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