



Bank of Canada holds again but inflation risk in focus

The Bank of Canada held its policy rate at 2.25 per cent today as widely expected, but the focus was its message, as the war in Iran and subsequent oil price spike has roiled the inflation outlook. It is in an unenviable position to balance the current soft economic activity and rising inflation risks. The Bank Rate was maintained at 2.50 per cent, with the deposit rate at 2.20 per cent.

Global economic conditions took centre stage with a backdrop of higher inflation and more uncertainty, while U.S. trade measures continue to reshape the economy and outlook. The Bank assumes a decline in oil prices (Brent) from \$90 in Q2 2026 to \$75 in mid-2027, which would still be sharply higher than pre-war levels owing to increased risk premium.

The Bank's communique highlighted higher volatility in the global economy and shifting growth prospects. This includes oil-induced weakness in oil-importing countries, uneven but solid growth in the U.S. and strength in China. Financial market conditions have ebbed and flowed with the war, but bond yields are higher, and equities have recovered.

Despite the war, the Bank remained consistent in its view for the Canadian economy and detailed in its accompanying Monetary Policy Report. Current patterns remained subdued, including a challenging labour market. Consumption and government are still supporting growth, while housing, exports and investment weighs. Going forward, while many consumers and businesses will see their positions deteriorate, the Bank emphasized that Canada is a net exporter of oil and income climbs because of higher prices. Its outlook for Canada GDP growth was revised slightly higher to 1.2 and 1.7 per cent for 2026 and 2027, with qualifications. Q1 2026 growth is forecast at 1.5 per cent. Provincial government investment is higher; housing weaker and with the oil impact relatively small. Growth is steady at 1.7 per cent in 2028. The change, while minor points to less potential for cuts. Globally, growth averages about 3 per cent over the three years.

Inflation has risen with higher energy prices (2.4 per cent in March) and is expected to climb to about 3 per cent in April. For monetary policy, higher oil prices have not fed into other components of inflation, but the Bank noted that *"this warrants close attention in the months ahead"*, highlighting concern with potential inflation upside. Inflation expectations, which are key for monetary policy decisions, have increased in the near-term, but longer-term expectations remain anchored. The Bank's inflation outlook averages 2.3 per cent this year and 2.1 per cent in 2027 but comes in at 2.0 per cent y/y by Q4 2027. Core inflation was nudged lower from 2.1 to 2.0 per cent in 2027. The Bank is "looking through" the conflict impact on inflation, for now.

Based on the Bank's current outlook for oil prices and growth, and current tariff environment remains steady, Governor Macklem suggested there would be little change in the policy rate in his speech, consistent with our call for no change this year.

That said, we see the risk tilted towards a hike amidst uncertainty. While there are downside risk from U.S. trade policy, particularly as the joint review of CUSMA plays out in coming months, we highlight the upward revision to growth, and statement, *"Governing Council is looking through the war's immediate impact on inflation but will not let higher energy prices become persistent inflation. As the outlook evolves, we stand ready to respond as needed."* Governor Macklem also stated that higher and elevated oil prices could lead to ongoing generalized inflation and could require consecutive increases in the policy rate. This was a bold statement. In contrast, an alternative scenario of more severe trade restrictions could impede growth, and a cut may be warranted.

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