Bank of Canada Post-Meeting

More to come

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Summary

- The Bank of Canada released its decision to cut the policy rate 25bp at the third consecutive meeting, bringing the policy rate down from 4.50% to 4.25%.
- This was fully priced in by the market and the majority of analysts surveyed by Bloomberg (30/34) were calling for a 25bp cut.
- The decision was followed by a press conference with Governor Macklem and Senior Deputy Governor Rogers.
- The Bank was keen to highlight that decisions will be made meeting by meeting and data dependence is key, while noting two main opposing forces likely to impact the path of policy going forward: On the upside, shelter inflation and some services components. On the downside, excess supply in the economy and slack in the labor market.
- We expect two more 25bp rate cuts this year pulling the policy rate down to 3.75% by year end.
- Turning to 2025, we expect four 25bp cuts next taking the policy rate down to its terminal low of 2.75%. This stands in contrast to the US where our Fed watcher, Philip Marey, expects three 25bp cuts this year and two 25bp next year before holding.
- In light of this monetary policy divergence, we maintain the view that USD/CAD will trade above 1.40 this year. The market is heavily short CAD, however, so expect pullbacks.

More to come

The Bank of Canada released it decision to cut the policy rate 25bp for third time in a row, bringing the policy rate down from 4.50% to 4.25%. We correctly predicted this decision and were in line with the majority (30/34) of Bloomberg surveyed economists. The market had also anticipated this decision with traders pricing in slightly more than a 25bp cut going into the meeting.

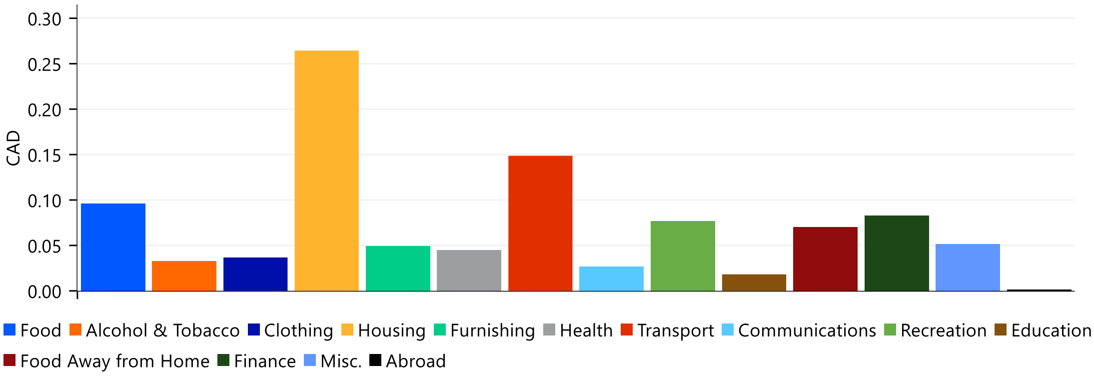
The decision was followed by a press conference with Governor Macklem and Senior Deputy Governor Rogers. The overall tone of the announcement wasn't dissimilar from what we've been hearing for the past few months now. While Macklem stated that it is "reasonable to expect further rate cuts," he continued to emphasized that decisions are made on a by-meeting basis, and that the Bank is not following a pre-determined path. He opened the press conference by outlining "two key considerations."

1) Headline and core inflation have continued to ease as expected.
2) As inflation gets closer to target, we want to see economic growth pick up to absorb the slack in the economy so inflation returns sustainably to the 2% target.

He indicated that inflation is continuing to cool, but perhaps there is fear that inflation is cooling too much.

For the first time since the cutting cycle began, Macklem took the time to recognize that the Bank is equally concerned about inflation being above *and below* the 2% target, highlighting that there is risk for inflation to cool too much under the pressure of high interest rates. The statement articulates that while shelter inflation remains far too high and services inflation stays sticky, excess supply may be a balancing downward force on inflation. However, while there are concerns about inflation perhaps being too low in the *future*, the inflation rate is still above target *right now*.

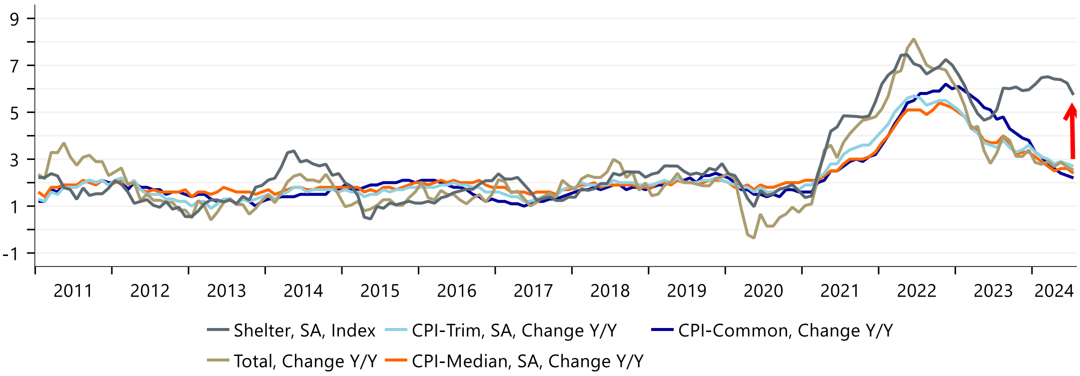
Figure 1: Consumer basket 2024 Q2



Source: Macrobond

Macklem stated that 25% of the average consumer's consumption basket is dedicated to housing. Therefore, shelter inflation has been a major drag on consumers' wallets, and bringing it down to a more manageable level will be crucial. However, confidence appears to be lacking on that front, and Macklem added that there is a risk that shelter costs could rise. Shelter inflation is still elevated at 5.74% y/y- which is well-above one standard deviation of the mean shelter inflation since 2012. One of the factors keeping shelter inflation elevated has been the recent surge in migration. Originally, the Bank-along with many economists hypothesized that increased migration would suppress inflation, as more people meant more competition for work, slowing wage growth. However, this is always a hard balance to predict, as an increasing population also means more demand for goods and services, including houses, which can boost inflation.

Figure 2: Housing inflation is still too high



Source: Macrobond

And as we highlighted in our most recent CAD Market Musings, the population surge has highlighted new challenges in the Canadian economy:

The health of the Canadian economy has been obfuscated by apparent resilience in GDP growth, with only two non-consecutive quarters of GDP contraction from 2022 to 2024 and a q/q GDP print of 1.659% for Q1 2024—though notably missing survey expectations of 2.2%. However, there is trouble brewing not too deep below the surface. The GDP growth we've seen has been aided by a surge in population growth with a rapidly rising migrant population, and, as we know, the number one contributor to growing GDP is a growing population.

Table 1: As a reminder... The Bank of Canada July 2024 Monetary Policy Report

	2023		*2024*		*2025*		*2026*	
	Jul '24	Apr '24	**Jul '24**	Apr '24	**Jul '24**	Apr '24	**Jul '24**	Apr '24
CPI Inflation	**3.9**	3.9	**2.6**	2.6	**2.4**	2.2	**2.0**	2.1
GDP Growth	**1.2**	1.1	**1.2**	1.5	**2.1**	2.2	**2.4**	1.9
Consumption	**0.9**	0.9	**1.1**	0.6	**0.7**	0.8	**1.4**	1.1
Housing	**-0.9**	-0.9	**0.1**	0.4	**0.5**	0.6	**0.5**	0.5
Government	**0.5**	0.5	**0.6**	0.7	**0.7**	0.7	**0.4**	0.4
Business	**-0.1**	-0.1	**-0.1**	0.0	**0.4**	0.3	**0.5**	0.2
Subtotal: DD	**0.5**	0.5	**1.7**	1.7	**2.3**	2.4	**2.8**	2.2
Exports	**1.8**	1.9	**0.6**	1.0	**1.2**	1.1	**0.7**	0.4
Imports	**-0.3**	-0.3	**-0.4**	-0.6	**-1.0**	-1.0	**-0.9**	-0.6
Subtotal: NetX	**1.5**	1.6	**0.2**	0.4	**0.2**	0.1	**-0.2**	-0.2
Inventories	**-0.8**	-1.0	**-0.7**	-0.6	**-0.4**	-0.3	**-0.2**	-0.1

Source: Bank of Canada

Bank of Canada Statements

September 4th, 2024

The Bank of Canada today reduced its target for the overnight rate to 4¼%, with the Bank Rate at 4½% and the deposit rate at 4¼%. The Bank is continuing its policy of balance sheet normalization.

The global economy expanded by about 2½% in the second quarter, consistent with projections in the Bank's July Monetary Policy Report (MPR). In the United States, economic growth was stronger than expected, led by consumption, but the labour market has slowed. Euro-area growth has been boosted by tourism and other services, while manufacturing has been soft. Inflation in both regions continues to moderate. In China, weak domestic demand weighed on economic growth. Global financial conditions have eased further since July, with declines in bond yields. The Canadian dollar has appreciated modestly, largely reflecting a lower US dollar. Oil prices are lower than assumed in the July MPR.

In Canada, **the economy grew by 2.1% in the second quarter**, led by government spending and business investment. This was slightly stronger than forecast in July, but preliminary indicators suggest that economic activity was soft through June and July. **The labour market continues to slow**, with little change in employment in recent months. **Wage growth, however, remains elevated** relative to productivity.

As expected, inflation slowed further to 2.5% in July. The Bank's preferred measures of core inflation averaged around 2 ½% and the share of components of the consumer price index growing above 3% is roughly at its historical norm. High shelter price inflation is still the biggest contributor to total inflation but is starting to slow. Inflation also remains elevated in some other services.

With continued easing in broad inflationary pressures, Governing Council decided to reduce the policy interest rate by a further 25 basis points. 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. Governing Council is carefully assessing these opposing forces on inflation. Monetary policy decisions will be guided by incoming information and our assessment of their implications for the inflation outlook. The Bank remains resolute in its commitment to restoring price stability for Canadians.

July 24th, 2024

The Bank of Canada today reduced its target for the overnight rate to 4½%, with the Bank Rate at 4¾% and the deposit rate at 4½%. The Bank is continuing its policy of balance sheet normalization.

The global economy is expected to continue expanding at an annual rate of about 3% through 2026. While inflation is still above central bank targets in most advanced economies, it is forecast to ease gradually. In the United States, the anticipated economic slowdown is materializing, with consumption growth moderating. **US inflation looks to have resumed its downward path**. In the euro area, growth is picking up following a weak 2023. China's economy is growing modestly, with weak domestic demand partially offset by strong exports. Global financial conditions have eased, with lower bond yields, buoyant equity prices, and robust corporate debt issuance. The **Canadian dollar has been relatively stable** and oil prices are around the levels assumed in April's Monetary Policy Report (MPR).

In Canada, economic growth likely picked up to about 1½% through the first half of this year. However, with robust population growth of about 3%, the economy's **potential output is still growing faster than GDP**, which means **excess supply has increased. Household spending**, including both consumer purchases and housing, **has been weak**. There are **signs of slack in the labour market**. The unemployment rate has risen to 6.4%, with employment continuing to grow more slowly than the labour force and job seekers taking longer to find work. Wage growth is showing some signs of moderating, but remains elevated.

GDP growth is forecast to increase in the second half of 2024 and through 2025. This reflects stronger exports and a recovery in household spending and business investment as borrowing costs ease. Residential investment is expected to grow robustly. With new government limits on admissions of non-permanent residents, **population growth should slow in 2025**.

Overall, the Bank forecasts **GDP growth of 1.2% in 2024, 2.1% in 2025, and 2.4% in 2026**. The strengthening economy will gradually absorb excess supply through 2025 and into 2026.

CPI inflation moderated to 2.7% in June after increasing in May. **Broad inflationary pressures are easing**. The Bank's preferred **measures of core inflation have been below 3%** for several months and the **breadth** of price increases across components of the CPI is **now near its historical norm**. Shelter price inflation remains high, driven by rent and mortgage interest costs, and is still the biggest contributor to total inflation. Inflation is also elevated in services that are closely affected by wages, such as restaurants and personal care.

The Bank's preferred measures of **core inflation** are **expected to slow** to about 2½% in the second half of 2024 and ease gradually through 2025. The Bank expects **CPI inflation to come down below co**re inflation in the second half of this year, largely **because of base year effects on gasoline** prices. **As those effects wear off, CPI inflation may edge up again** before settling around the 2% target next year.

With broad price pressures continuing to ease and inflation expected to move closer to 2%, Governing Council decided to reduce the policy interest rate by a further 25 basis points. Ongoing excess supply is lowering inflationary pressures. At the same time, price pressures in some important parts of the economy—notably shelter and some other services—are holding inflation up. Governing Council is carefully assessing these opposing forces on inflation. Monetary policy decisions will be guided by incoming information and our assessment of their implications for the inflation outlook. The Bank remains resolute in its commitment to restoring price stability for Canadians.

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