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April 10, 2024

Bank of Canada: Moving slowly towards cuts

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Why rush? That seems to be the message from the Bank of Canada at the moment, as it once again kept the overnight rate on hold at 5% but appears to be moving slowly in the direction of lowering interest rates. While the final paragraph of the statement no longer mentions concern about the "persistence" of core inflation, and instead acknowledges that it has "eased further" in recent months, the Governing Council would like to see evidence that this momentum is "sustained" before pulling the trigger on interest rate cuts. The Bank gets to see two inflation prints, including one next week, before its June policy decision, so there will be plenty of new information available at that point for them to judge if downward momentum in underlying price pressures has been sustained. During today's press conference, Governor Macklem acknowledged that a June cut was within the "realm of possibilities".

- Within the Monetary Policy Report, we saw the near-term increase in GDP and lowering of CPI forecasts that were necessary given the data flow since January. Even with higher oil price assumptions than in the prior MPR, the Bank still showed year-end inflation a couple of ticks below their prior assessment (2.2% vs 2.4%), which could be another sign that they are slowly moving towards being more comfortable about reducing interest rates.
- The 2.8% annualized growth forecast for Q1 is in line with our forecast and slightly below current tracking, but the 1.5% pace in Q2 is maybe a little optimistic if (as we expect) some of the strength in Q1 was linked to an easing of prior supply constraints and milder than normal weather. For 2024 as a whole, roughly half of the upgrade to the GDP growth forecast (to 1.5% from 0.8%) is linked to stronger population growth and by extension a higher potential growth rate. In contrast, a downgrade to potential growth in 2025 as new restrictions on non-permanent residents slows population growth has driven a slight downgrade to 2.2% (from 2.4% previously).
- In another indication that the Bank believes stronger growth in 2024 is being driven by a higher pace of potential growth, their view of the current output gap is broadly unchanged since January (still between -0.5% and -1.5%) despite the sharp upward revision made to near-term GDP growth rates.
- As is customary in April, the Bank reassessed its view on the neutral rate, with the midpoint rising 25bp as we expected to 2.75%. However, the Governor stated that this upgrade isn't having an impact on their deliberations in the near term, as it is a theoretical assessment based on a world where there are no shocks (either positive or negative).

Re: Economic forecast —We currently forecast a first interest rate cut in June and a total of four 25bp moves before the end of the year. To steal a line from Governor Macklem's press conference today, that outlook still appears to be within the realm of possibility, but is reliant on core inflationary pressures sustaining their current lower rates or easing further.

Re: Markets — The Canadian dollar was already trading weaker on the day due to stronger than expected US CPI data released earlier in the session, and the currency held onto this weaker level following the Bank of Canada's release. Canadian bond yields, which were trading higher following the US data, gave back some of that earlier move following the statement and press conference.

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