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Bank of Canada: Two in a row with more to go

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Two in a row with more to go was the message from the Bank of Canada today, as economic slack, or “excess supply”, has the economy no longer in need of such punitive interest rates to contain inflation. Today’s quarter point cut to 4.50% came as no surprise, and the June/July moves were consistent with our forecast for 2024’s easing pace. The press conference statement talked about downside risks taking more weight in their deliberations, opening the door to a further cut in September. We continue to anticipate two more 25bp cuts before the end of the year, but now expect those to come in September and October (rather than October and December previously).

- The statement highlighted a pickup in economic growth ahead, but note that lower interest rates are cited as a driver of that growth, so there is clearly an intention to continue to trim rates this year and in 2025. While the Bank cites a few pockets of inflation, including wages, it also notes that the breadth of inflation has diminished, and one of the sources of pressure is tied to mortgage interest, which will ease as the Bank lowers the policy rate.
- Governor Macklem's opening statement for the press conference once again stated that, if inflation continues to ease, it would be "reasonable" to expect further interest rate cuts. While this was in line with the June decision, on this occasion it was noted that the timing of further cuts would depend on how the opposing forces of strong shelter inflation but growing economic slack play out. In a more dovish change relative to June's opening statement, the Governor noted that downside risks were taking on an "increased weight" in the Governing Council's decisions.
- The Monetary Policy Report showed a downgraded GDP projection for 2024 (now 1.2% versus 1.5%), although this largely reflected downward revisions to prior quarters and the Bank still expects to see 1.5% annualized growth in Q2 and projects an acceleration to 2.8% in Q3. The output gap as of Q2 2024 is estimated to be in the range of -0.75% to -1.75%. That's slightly wider than the assessment in April's MPR, reflecting marginally below potential growth in Q2 and downward revisions to prior quarters.
- Given how wide the Bank believes that the output gap currently is, policymakers see plenty of scope for non-inflationary growth. GDP is forecast to rise by 2.1% in 2025 (previously 2.2%) and 2.4% in 2026 (previously 1.9%), with inflation at the end of both years in line with their inflation target of 2.0%. While the CPI projections for the end of 2025 and 2026 are only marginally lower than in the April MPR (2.1%), this slight change highlights the assertion made in Governor Macklem's opening statement that policymakers are "increasingly confident" that inflation is on a path back to target. The upgrade in GDP growth expected for 2026 partly reflected a reassessment of population growth at that time, with the Bank expecting less of a deceleration relative to its April MPR projections.
- A study on the drivers of inflation within the Canadian economy in today's MPR showed that services inflation excluding shelter was lower in Canada than in other developed countries, and indications that wage growth is moderating should bring further deceleration in that inflation category in the future.

Re: Economic forecast — The Bank of Canada continues to expect that growth in the economy will accelerate quite quickly in the second half of the year, albeit not by enough to disrupt the easing path of inflation. We think it will take a bit more time for the reduction in interest rates to bring a reacceleration in growth, and as a result our current forecast for Q3 GDP is weaker than the MPR projection of 2.8%. Weaker growth and continued easing in inflation will likely bring two further interest rate cuts in September and October, to end the year at 4.00%.

Re: Markets — Today's 25bp cut in interest rate was almost fully priced into financial markets, and as a result bond yields and the Canadian dollar fell only modestly following the decision.

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