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Bank of Canada: Done with the big guns

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The Bank of Canada signalled that it's done with the big guns, but it likely still has bullets to fire as it eases rates with an eye to accelerating economic growth ahead. With the jobless rate jumping to 6.8% in November, and second half growth looking to fall short of its projections, the central bankers had more than enough reason to deliver another outsized 50 basis point rate cut today, taking the rate to 3.25%. Inflation is running near its 2% target, and economic slack (or "excess supply" as the Bank puts it) will continue to lean against price pressures. Getting the pick up in growth that will be necessary to close that slack would require policy rate to get at least a bit below neutral, which we estimate lies at 2.75%. Even the Bank concedes that they no longer need policy in restrictive territory, and we're now only at the very top end of the Bank's 2.25% to 3.25% estimated range for the neutral rate.

But having now eased "substantially," Macklem has taken the opportunity to drop some hints that they are done with 50 basis point cuts, and no longer want to give specific forward guidance on what comes next, particularly with an uncertain backdrop for both Canadian fiscal policy and US tariffs. There's still an easing bias, however, since the statement talks about how they will judge the need for further reductions; there's no mention of the potential for the next move to be higher. At the press conference Macklem said they will continue to consider further cuts, but expects to be moving more gradually, and take those decisions one meeting at a time.

- While conceding that growth in the second half of the year looks likely to trail its forecasts, the Bank cited some early signs that lower interest rates are starting to kick in, noting a pickup in consumption and housing. Looking ahead, both demand and potential growth will be lower due to reduced immigration levels, but that's seen as not having much impact on inflation.
- The Bank is probably happy that this wasn't a rate decision that comes with an updated economic forecast. We're in the same boat as the central bank at this point, waiting for developments on two fronts that could impact both growth and monetary policy ahead, in two opposing directions. While the fiscal measures announced to date will have only temporary impacts, which the Bank will look through, there are rumours of more substantial federal measures being considered for the upcoming Fall Economic Statement. If these entail a timely, material, and lasting boost to economic activity, that could lean against the need for aggressive rate cuts ahead.
- But on the other side, there's a looming threat of US tariffs. That uncertainty will weigh on business investment even if the tariffs never arrive, but could entail a major hit to exports if actually delivered, and therefore require more monetary stimulus to Canadian domestic demand. Who can blame the Bank of Canada for dropping forward guidance and leaving forecast details until January?
- That said, barring material fiscal stimulus, the fact that the economy is growing below potential, with an accelerating climb in unemployment, suggests that we'll need to take rates somewhat below neutral to achieve the Bank's objectives for a growth improvement. Our estimate of the neutral rate sits at 2.75%, the midpoint of the Bank's estimated range, and we see the overnight rate getting to 2.25% on a series of quarter point cuts ahead.

Re: Economic forecast — We are looking for economic growth to pick up in 2025 to just under 2%, but that will require some combination of monetary or fiscal stimulus. For now, the fiscal measures haven't moved the needle enough to do the job are on their own, so we're sticking to our projection for the overnight policy rate to ease by a quarter point at the next four decision dates, and troughing at 2.25%. But there are risks from tariffs that could take policy rates lower, or major fiscal stimulus in Canada that could substitute for lower rates. We'll know more on the latter front after the mid-year fiscal update next week.

Re: Markets — Bond yields moved higher as central bank dropped specific guidance on further rate cuts ahead, but remained well below where they stood prior to the recent jobs data. Similarly, the Canadian dollar recovered some ground, but remained weaker than before the jobs data cemented expectations for today's 50 bp move.