

Economics

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Bank of Canada: A first step down

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The Bank of Canada took a first step down the path towards lower interest rates, reducing the overnight rate by 25bp to 4.75%. With core inflation decelerating and growth remaining tepid there really wasn't a good excuse not to begin the process of moving rates lower. While today's interest rate cut had been mostly priced in by financial markets, hints that follow up moves could come faster than markets previously anticipated saw bond yields and the Canadian dollar fall. We continue to forecast a further 25bp reduction at the next meeting in July, and a total of 4 cuts (3 more after today's) by the end of the year.

- The statement suggested that policymakers now have "increased" confidence that inflation is coming back down to target due to recent softer CPI prints. It pointed to "continued evidence" that core inflation is easing, which meant that policy no longer needed to be as restrictive as it has been. It also noted that the breadth of inflationary pressures were "near their historic average".
- However, the Bank also noted that "risks to the inflation outlook remain", including wage pressures within the economy which are moderating only "gradually" as well as global supply pressures and house prices.
- The opening statement for the press conference noted that it would be "reasonable" to expect further rate cuts if inflation continues to ease, although it also reminded investors that decisions would be taken "one meeting at a time". With the economy thought to be operating below its potential, the Governor suggested that there was room for growth to accelerate further without adding to inflationary pressures.
- In the press conference the Governor was careful not to pre-commit to another interest rate cut in July, instead reiterating that any future decision will be taken one at a time and depend on incoming data. He also, however, reiterated that the Bank doesn't need to move "lock and step" with the Federal Reserve and that they are not "close" to the limit of how far it can diverge from policy in the US.

Re: Economic forecast —One interest rate cut isn't going to do much to ease the pressure households are facing as mortgages come up for renewal, and as a result we think that the Bank of Canada will need to reduce interest rates further and by more than financial markets are expecting in order to accelerate growth within the economy. We forecast three more cuts before the end of the year, with the policy rate finishing 2024 at 4.0%.

Re: Markets — Financial markets had mostly priced in today's cut to the overnight rate beforehand, but long rates and the Canadian dollar still moved lower on the news as a perceived dovish tone suggests the likelihood of a greater number of follow up moves.

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