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Bank of Canada: Comfortably in neutral for now

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The Bank of Canada left the overnight rate unchanged again, as widely anticipated. The statement continued to point to risks from the conflict in the Middle East against US trade policy uncertainty. While the wording around possibly needing consecutive hikes if energy prices spillover into broader inflation was removed, as was the reference to possibly needing cuts if the US imposed new trade barriers on Canada. In the press conference, however, Governor Macklem highlighted that monetary policy would be nimble and could still react in such a way if conditions warrant it. Policymakers therefore struck a data dependent and relatively neutral tone. Labour market conditions are still viewed as soft, despite the more constructive labour market reports received lately, leaving ample economic slack to be absorbed. And with core inflation remaining close to target, CIBC expects the BoC will leave the overnight rate unchanged for the remainder of this year.

Headline inflation is expected to stay elevated in June but return to target in early 2027, assuming oil prices come down and stabilize between US$70-75/bbl. Near-term inflation is slightly higher than what was expected in the prior MPR, due to higher oil prices, elevated gasoline refinery margins, and a weaker Canadian dollar. Headline CPI is expected to average 2.5% in 2026 and 2.0% in 2027. The core inflation projection was in line with April's forecast, with inflation in that basket expected to hover around 2% for the rest of the year, with the economy in excess supply.

The BoC expects GDP growth to pickup to 2.5% q/q annualized in Q2, up from 1.5% in the previous MPR projection and in line with growth indicators received so far. That's driven by growth in exports (helped by stronger energy exports), while consumption is being helped by the one-time federal government transfer to households. Housing activity is also expected to shift from being a drag on growth to neutral. The BoC's forecast is roughly in line with CIBC's forecast, but some of the strength in Q2 is temporary and tied to the FIFA World Cup, so we see scope for slower growth in Q3 as that boost fades, with the BoC also projecting a slowdown to 1.5%.

Exports in sectors that aren't subject to tariffs have picked up and the BoC noted that businesses are navigating trade policy uncertainty, with the latest business outlook survey showing a rise in investment intentions. Looking into 2027, a continued recovery in exports will help boost growth, as will fiscal stimulus in the form of capital projects getting off the ground. CIBC expects GDP growth to pickup to 2.0% in 2027, slightly above the BoC's 1.8% forecast.

Re: Economic forecast — We continue to view the Bank as patient and data dependant, waiting to see how risks to the economy and inflation play out. With growth on an improving trajectory and core inflation still contained, the BoC is set to remain on hold for the remainder of the year as economic slack is absorbed, assuming that oil prices ease off from here and US trade barriers on Canada don't worsen.

Re: Markets — The outcome of this decision was largely as expected, with bond yields dropping off a bit as a more hawkish tone may have been expected. The market is still pricing in roughly one hike by the end of 2026, as the situation in the Middle East remains fluid and oil prices are still elevated.