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Bank of Canada: Waiting and seeing

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The Bank of Canada held interest rates steady again today, as policymakers wait to see how the dueling risks to growth and inflation from elevated oil prices on the one hand, and trade uncertainty on the other, play out. In keeping its overnight rate steady at 2.25%, the Bank continued to state that it would "look through" the near term spike in inflation driven by global oil prices, but also that it would guard against that turning into "persistent inflation". With oil prices off their earlier highs and with the Bank noting only "limited evidence" of pass through so far to other components, we continue to believe that the BoC won't feel forced to raise rates in response to the oil shock, and continue to see the current rate setting remaining in place throughout 2026.

While the Bank noted that oil prices are currently around $10/bbl higher than the April MPR assumptions, and that this could mean headline inflation will "hover" close to 3% for a little longer than previously anticipated, it also noted that core measures of inflation have been subdued. The statement pointed out that core measures of inflation have moved down to 2%, and that the share of components growing above 3% is close to its historic average. While the statement made note of the latest strong employment report, it also justifiably stated that, through the volatility, employment was little changed since the start of the year and that the unemployment rate has been largely range bound between 6.5% and 7%.

The opening remarks for the press conference once again stated that there are scenarios that could warrant both lower interest rates (new tariffs) as well as rate hikes (oil price pass through to generalized inflation). By retaining the word "consecutive" for hikes in a possible high oil price and generalized inflation scenario, the Bank continued to play into market expectations that the magnitude of risks is not symmetric.

During the Q&A, Governor Macklem reiterated that the Bank will be looking at core measures of inflation and inflation expectations as it assesses whether price pressures are broadening into other areas, rather than how long headline inflation is close to or above 3%. The Governor hinted that the weakness in Q1 GDP hadn't changed the Bank's view of economic slack, suggesting most of the miss was due to an expected decline in government spending, and that the Bank expects growth to have resumed in Q2. Regarding CUSMA renegotiations, the Governor noted that even though uncertainty remains, the Bank's surveys suggest that companies are adjusting to the more uncertain trade relationship with the US and that investment intentions have improved.

Re: Economic forecast — We view today's communication as highlighting a very patient central bank that has plenty of time to wait and see how risks to the economy play out. We continue to see no change in interest rates this year, and that rates at their current level should support a recovery in the economy later this year and into 2027 assuming some of the uncertainties regarding oil prices and trade lessen during that time period.

Re: Markets — While the tone from the Bank of Canada today was very neutral and little changed relative to the April decision, financial markets appear to have been expecting a more hawkish tone and as a result bond yields moved lower as expectations for rate hikes this year were slightly reduced.

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