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Bank of Canada: Not now, maybe later

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The Bank of Canada chose not to provide fresh stimulus to the Canadian economy now, keeping the overnight rate steady at 2.75%, but did hint that rate cuts are still possible in the future to help navigate the current period of trade uncertainty. Future cuts will rest on evidence of growth remaining weak but also inflationary pressures being contained, and we expect to see enough on both fronts to bring a 25bp rate cut in July.

On the inflation front, Governor Macklem noted concern that underlying inflation could be stronger than they initially thought, and that it was too early to have seen the impact from retaliatory tariffs on consumer prices. When asked during the press conference, he was careful not to provide a clear line in the sand as to what evidence of "contained" inflation means. While we can't argue against the acceleration seen in core measures of inflation recently, we do think that this has partly been due to retaliatory tariffs, particularly in areas such as food where passthrough happens quite quickly. With two more inflation readings to be released before the Bank's July meeting, and with a full MPR forecast at hand, we expect there will be enough evidence to show that tariff pass through may simply be happening faster than the Bank first anticipated, rather than underlying inflation being notably stronger.

We also expect to see further evidence that the economy is weakening between now and the July meeting, particularly in the labour market. On that front, the Governor noted that the labour market had weakened, but that job losses were concentrated in trade-sensitive areas of the economy. While that is true, we have also seen aggregate job growth in other sector of the economy slowing, and if the unemployment rate rises above 7% by the July meeting then that may be difficult for policymakers to ignore. Although Governor Macklem noted "some resilience" among consumers and businesses, he also noted that many businesses are reporting plans to scale back hiring due to the trade uncertainty.

However, for now the Governor reiterated that the central bank is being less forward-looking than normal due to trade uncertainties, and so we will need to see clear evidence of softer core inflation and further slack being built up in the economy for the Bank to return to interest rate cuts.

Re: Economic forecast — While there was a "clear consensus" to hold interest rates steady today, the Bank did maintain a bias towards easing in the future. We expect that there will be enough evidence of slack building up in the economy, and that core inflation is being impacted by retaliatory tariffs, for policymakers to feel comfortable cutting rates by 25bp in July and then again in September.

Re: Markets — Today's hold in interest rates was expected by financial markets, and the decline in bond yields (but appreciation in the C$) seen following the decision was likely more a reaction to weak US ISM data rather than the BoC policy decision.

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