April 10, 2024

Conditions for cuts? More of the same.

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Rate Statement

Once again, the Bank of Canada left its overnight rate target unchanged at 5.0%, a decision in line with a unanimous consensus. As for its balance sheet policy, "the Bank is continuing its policy of quantitative tightening". Here are additional highlights from the rate statement (analysis of the updated MPR and its projections follows):

- Governing Council says inflation is "still too high and risks remain" but price pressures have eased in recent months. Going forward, they'll be looking for evidence that "this downward momentum is sustained".
- They'll continue to focus on the balance between demand and supply, inflation expectations, wage growth, and corporate pricing behaviour.
- The statement reiterated that the economy moved into "excess supply" in the second half of 2023 but economic growth is forecast to "pick up" in 2024 on strong population growth, a recovery in household spending and marginal government spending. Business investment is also expected to "recover gradually". Demand for housing remains robust which is leading to "strenghening" residential investment. .
- On the labour market, they note that a "broad range of indicators suggest that conditions continue to ease". They also reiterated their assessment from March that "there are some recent signs that wage pressures are moderating".
- As for inflation, easing price pressures have become "more broad-based across goods and services", although shelter inflation is "very elevated". They say that recent data suggests downward momentum in core inflation.
- In the opening statement to the press conference, Macklem spoke to the conditions needed for cutting rates: "We are seeing what we need to see, but we need to see it for longer to be confident that progress toward price stability will be sustained".

March 6, 2024: *"The Council is still concerned about risks to the outlook for inflation, particularly the persistence in underlying inflation. Governing Council wants to see further and sustained easing in core inflation and continues to focus on the balance between demand and supply in the economy, inflation expectations, wage growth, and corporate pricing behaviour."*

April 10, 2024: *"While inflation is still too high and risks remain, CPI and core inflation have eased further in recent months. The Council will be looking for evidence that this downward momentum is sustained. Governing Council is particularly watching the evolution of core inflation and continues to focus on the balance between demand and supply in the economy, inflation expectations, wage growth, and corporate pricing behaviour."*

Monetary Policy Report

The central bank also released the latest edition of its Monetary Policy Report (MPR), which showed a significantly more robust growth trajectory in 2024 (from +0.8% to +1.5%). That reflects greater demand from the United States (i.e. sturdier exports), a more supportive fiscal backdrop, an easing of financial conditions and, above all, stronger-than-expected population growth. Highlighting the importance of this last factor, the Bank of Canada noted that it is still forecasting negative per capita GDP growth in 2024. Further out the forecast horizon, the BoC sees the economy expanding 2.2% next year (down from the 2.4% in January's MPR) and 1.9% in 2026.

Despite a sizeable upgrade to the recent growth trajectory (Q4 GDP figures were not as weak as the BoC originally anticipated and Q1 is tracking towards a strong increase), the central bank believes that the economy remains in excess supply. They've esimated the output gap to be somewhere between -0.5% and -1.5% as of the first quarter. Reconciling these seemingly contradictory trends was a 0.4% upgrade to potential output this year. The BoC now pegs potential at 2.5%, reflecting stronger population growth. Moderate excess supply was expected to remain through 2024 and then slowly dissipate in 2025 and 2026 "as demand growth remains solid and supply growth moderates." The BoC indeed sees potential growth fading to 1.7% next year, a number consistent with the federal government's recently announced targets for non-permanent residents. With this revision more or less offsetting the one made for 2024, the level of potential output remains roughly unchanged by the end of 2025.

Table: Stronger growth and softer inflation in new MPR

BoC forecasts for real GDP and CPI inflation

	Projection source	Q4	Q1	Q2	2023	2024	2025	2026
Real GDP	October MPR	0.8	-	-	1.2	0.9	2.5	-
	January MPR	0.0	0.5	-	1.0	0.8	2.4	-
	April MPR	1.0	2.8	1.5	1.1	1.5	2.2	1.9
CPI inflation	October MPR	3.3	-	-	3.9	3.0	2.2	-
	January MPR	3.3	3.2	-	3.9	2.8	2.2	-
	April MPR	3.3	2.8	2.9	3.9	2.6	2.2	2.1

Source: NBF, Bank of Canada | All figures are Y/Y except for quarterly GDP which is Q/Q. GDP figures are SAAR.

The central bank also increased its estimate for the neutral nominal policy rate to a range of 2.25% to 3.25%, up 25 basis points from last year's assessment. The upgrade was made to reflect upward revisions to the U.S. neutral rate (because Canada is a small open economy, its neutral rate of interest is influenced by global economic conditions) and stronger growth in trend labour input (read: population growth). "A fast-growing population increases the proportion of young borrowers relative to middle-aged and older savers, and this puts upward pressure on the neutral rate", the MPR said.

Turning to inflation, the near-term outlook was revised down reflecting softer-than-expected data in January and February. Specifically, Q1 inflation was downgraded from 3.2% to 2.8%, leading to a revision to the full-year projection from 2.8% to 2.6%. Ongoing excess supply was expected to help inflation return to target in 2025, although the BoC continued to flag the meaningful risk that it could adjust more slowly. Specifically, it pointed to sticky services prices and the recent increase in gasoline prices. On the other hand, it mentioned a looser labour market, early evidence of weaker wage growth and goods deflation as factors that would likely contribute to bringing inflation down.

Press Conference:

Not surprisingly, the first question pertained to the possibility of a rate cut at the next decision in June. Macklem agreed that this is "within the realm of possibilities". Expanding on that thought, he explained: "If things evolved broadly in line with the outlook we've published today, we will be becoming more confident that we're clearly on a path to 2% inflation and it will be appropriate to cut our interest rate". In addition to inflation progress, Macklem highlighted that many of the BoC's indicators (e.g., corporate pricing behaviour, inflation expectations) "are moving in the right direction". As for inflation risks, housing is one (but not the only one). They expect house prices to pick up but there's a risk prices could rise faster than they expect. He was also asked about the inflation impacts from a weaker loonie. Not surprisingly, he downplayed the influence of the currency on setting monetary policy. As for the potential to 'import' hotter U.S. inflation, Macklem indicated that he doesn't see this as likely even if "U.S. developments have an impact on Canada".

When it comes to the BoC's upgraded economic outlook, Macklem noted that the main factor driving the revision was stronger population growth in the first half of the year. On the flip side, the central bank downgraded their outlook for population growth in the second half reflecting new government caps on non-permanent residents. However, by that time they see household spending and business investment rebounding. He didn't care to comment on fiscal policy but just stressed that they take government spending plans as is and builds these into their models. Thus, July's MPR will incorporate the federal budget (which will be released on April 16th). Overall, they expect choppiness in the GDP data ahead but, on average, see growth averaging 2% per quarter this year.

Elsewhere, Macklem indicated that was a "clear consensus" to hold today, although there is some diversity of views when it comes to how close they are to cutting rates. Speaking to the BoC's upgraded neutral rate forecast, the Governor admitted it's an input to their models, but it doesn't have much influence on setting policy in real time.

Bottom Line:

This suite of communications came broadly in line with our expectations, clearly reflecting what has been very encouraging inflation data in the last two months. While the statement doesn't explicitly state that rate cuts are now on the table, this is effectively what was communicated, particularly in the press conference. Indeed, Macklem said they're already "seeing what [they] need to see" when it comes to determining when rate cuts will be appropriate. They just need to see it play out for longer. That clearly puts June on the table for a potential cut (Macklem admitted as much in his press conference) with two CPI reports due to be released before that decision. That said, they've clearly left themselves plenty of flexibility if the data doesn't remain as soft as it has been of late. Therefore, we don't see June as a slam dunk for a rate cut. While policymakers are cautiously optimistic that inflation pressures will continue to subside, we have no doubt they'd delay the onset of cuts if underlying inflation were to re-accelerate. Simply put, incoming data will guide the June decision but at least policymakers are now willing to discuss lowering rates.

The Bank's next decision will take place on June 5th. The Summary of Deliberations for today's decision will be released on April 24th.

Here is the interest rate statement:

Bank of Canada maintains policy rate, continues quantitative tightening

The Bank of Canada today held its target for the overnight rate at 5%, with the Bank Rate at 5¼% and the deposit rate at 5%. The Bank is continuing its policy of quantitative tightening.

The Bank expects the global economy to continue growing at a rate of about 3%, with inflation in most advanced economies easing gradually. The US economy has again proven stronger than anticipated, buoyed by resilient consumption and robust business and government spending. US GDP growth is expected to slow in the second half of this year, but remain stronger than forecast in January. The euro area is projected to gradually recover from current weak growth. Global oil prices have moved up, averaging about $5 higher than assumed in the January Monetary Policy Report (MPR). Since January, bond yields have increased but, with narrower corporate credit spreads and sharply higher equity markets, overall financial conditions have eased.

The Bank has revised up its forecast for global GDP growth to 2¾% in 2024 and about 3% in 2025 and 2026. Inflation continues to slow across most advanced economies, although progress will likely be bumpy. Inflation rates are projected to reach central bank targets in 2025.

In Canada, economic growth stalled in the second half of last year and the economy moved into excess supply. A broad range of indicators suggest that labour market conditions continue to ease. Employment has been growing more slowly than the working-age population and the unemployment rate has risen gradually, reaching 6.1% in March. There are some recent signs that wage pressures are moderating.

Economic growth is forecast to pick up in 2024. This largely reflects both strong population growth and a recovery in spending by households. Residential investment is strengthening, responding to continued robust demand for housing. The contribution to growth from spending by governments has also increased. Business investment is projected to recover gradually after considerable weakness in the second half of last year. The Bank expects exports to continue to grow solidly through 2024.

Overall, the Bank forecasts GDP growth of 1.5% in 2024, 2.2% in 2025, and 1.9% in 2026. The strengthening economy will gradually absorb excess supply through 2025 and into 2026.

CPI inflation slowed to 2.8% in February, with easing in price pressures becoming more broad-based across goods and services. However, shelter price inflation is still very elevated, driven by growth in rent and mortgage interest costs. Core measures of inflation, which had been running around 3½%, slowed to just over 3% in February, and 3-month annualized rates are suggesting downward momentum. The Bank expects CPI inflation to be close to 3% during the first half of this year, move below 2½% in the second half, and reach the 2% inflation target in 2025.

Based on the outlook, Governing Council decided to hold the policy rate at 5% and to continue to normalize the Bank's balance sheet. While inflation is still too high and risks remain, CPI and core inflation have eased further in recent months. The Council will be looking for evidence that this downward momentum is sustained. Governing Council is particularly watching the evolution of core inflation, and continues to focus on the balance between demand and supply in the economy, inflation expectations, wage growth, and corporate pricing behaviour. The Bank remains resolute in its commitment to restoring price stability for Canadians.

Information note

The next scheduled date for announcing the overnight rate target is June 5, 2024. The Bank will publish its next full outlook for the economy and inflation, including risks to the projection, in the MPR on July 24, 2024.

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