NATIONAL BANK OF CANADA FINANCIAL MARKETS

April 14, 2025

A (temporary) pause to assess

By Ethan Currie & Warren Lovely

The Bank of Canada will make its third rate decision of 2025 on Wednesday. After delivering seven consecutive cuts, we see the Bank holding its target policy rate at 2.75%, opting for a 'wait-and-see' approach amidst an uncertain backdrop. As it stands now, OIS pricing still indicates a 30% probability of a 25bp cut. Markets have whipsawed on trade war news – in both directions – and recession risks have seemingly moderated after U.S. 'reciprocal' tariff aggression was dialed back. Still, the assumed economic impact from tariffs puts the central bank in a tricky position, as monetary policy cannot seriously support growth and contain inflation simultaneously. The BoC wants to ensure that tariff-related impacts on prices do not result in ongoing inflation (or elevated long-run inflation expectations). That's primarily why forward-looking policy is set to be avoided. When it comes to the economic outlook, 'soft data' indicators are worrisome as consumers and businesses register growing anxiety. Beyond a weak employment report from March, 'hard data' have yet to deteriorate more broadly. Meantime, inflation has regained some momentum. A pre-BoC CPI print (due Tuesday) is hardly an unadulterated one, as a GST-related bump and an energy-related drop could offset one another and contribute to more forecasting noise. Consistent with our baseline forecast, the anticipated 'pause' from the BoC on Wednesday should not be interpreted as the conclusion of the BoC easing cycle. Assuming 'soft data' anxiety is clearly converted into 'hard data' weakness, the next step lower on the BoC overnight target could come as soon as their next decision on June 4th. The nation's fiscal policies will likewise be clear(er) by then.

Tariff growth scares have stirred (shaken) markets…: After absorbing most of the initial trade jabs from the U.S., Canada has been largely spared from more recent tariff action. That's contributed to BoC rate cuts being pushed back in pricing, but the larger moves have come from escalating global trade conflict (and subsequent reprieves). On-again, off-again announcements have whipsawed markets, though it seems like the 'worst case' tariff scenarios have already presented themselves. While tariffs remain top-of-mind for the BoC, the stabilization of financial conditions reduces the likelihood of immediate policy rate relief.

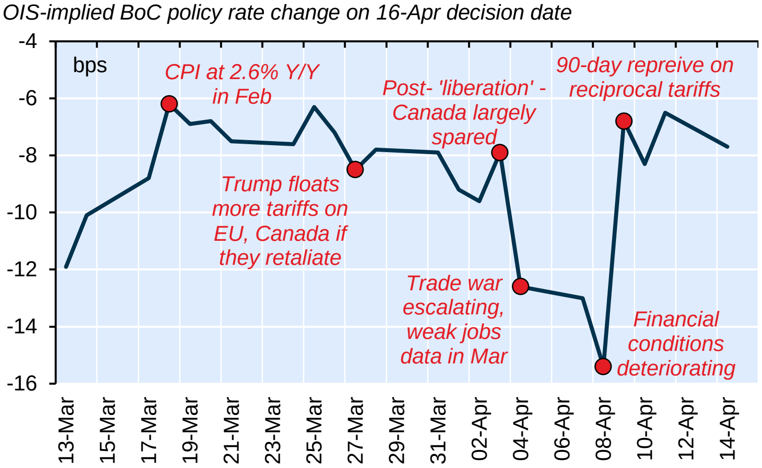
…but BoC remains committed to anchored inflation: While not resorting to the 'T word' yet, Macklem has stressed the vitality of tariff-related inflation being contained to a one-time move, rather than a prolonged upward drift – *"simply put, we need to make sure that a tariff problem doesn't become an inflation problem"*. The Bank is expecting 2.5% inflation in March, though tomorrow's print will be distorted by GST impacts and downward pressure on energy prices. It's likely that policymakers remain keyed in on long-run expectations and await a clear trend in price pressures.

Forward-looking policy to be avoided…: Appreciating uncertainty / volatility, Macklem has also communicated the risks in forward-looking decision-making - *"If we were to guess where the economy is heading and make policy to optimize that outcome, we'd risk getting it wrong"*. He also noted that this might mean "*acting quickly when things crystallize*" and suggested a forecast range to be presented in April's MPR – *"I don't think it would have a single central projection"*. It's worth noting that an uncertain fiscal backdrop remains, which could have a substantial impact on future policy rate decisions, should government balance sheets be deployed in response to tariff-related weakness.

…notwithstanding some worrisome indicators… Survey-based measures are hinting at a lot of tariff-related pain. That's true for both consumers and businesses, which cite expectations of tighter financial conditions, slowing activity, and rising inflation. This has yet to translate *broadly* into 'hard data', although some weakness has presented itself in the labour / housing market. As per the rhetoric surrounding forward-looking policy above, while worrying, we don't think the data is enough to justify a cut at this time.

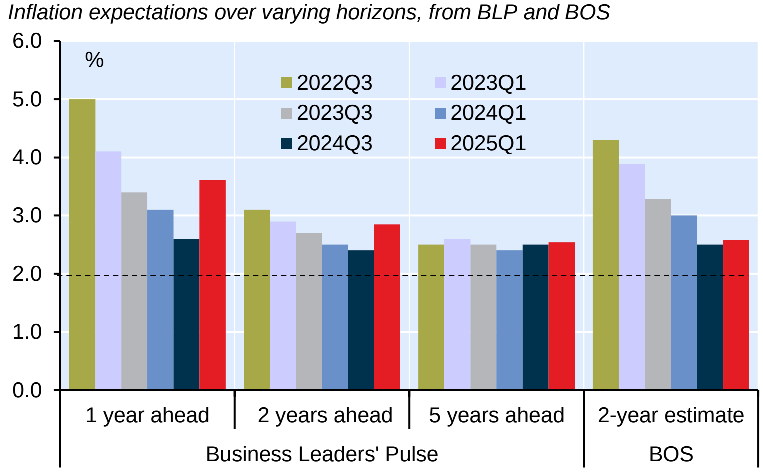
…which might get the BoC off sidelines in June: Despite any potential improvements on the tariff front, trade war action to date will leave scars on global growth going forward. If / when 'soft data' anxiety translates to 'hard data' weakness, the BoC is likely to step in with additional easing this year. We see scope for this as USMCA compliance may also help to alleviate some tariff-related inflation in Canada. All told, NBC expects BoC policy to reach 2.00% by year-end.

April rate cut odds swing on tariff headlines
OIS-implied BoC policy rate change on 16-Apr decision date



Source: NBC, Bloomberg

After trending down, inflation expectations pick back up
Inflation expectations over varying horizons, from BLP and BOS



Source: NBC, Bank of Canada

Latest policy statement: March 12, 2025

Bank of Canada reduces policy rate by 25 basis points to 2.75%

The Bank of Canada today reduced its target for the overnight rate to 2.75%, with the Bank Rate at 3% and the deposit rate at 2.70%.

The Canadian economy entered 2025 in a solid position, with inflation close to the 2% target and robust GDP growth. However, heightened trade tensions and tariffs imposed by the United States will likely slow the pace of economic activity and increase inflationary pressures in Canada. The economic outlook continues to be subject to more-than-usual uncertainty because of the rapidly evolving policy landscape.

After a period of solid growth, the US economy looks to have slowed in recent months. US inflation remains slightly above target. Economic growth in the euro zone was modest in late 2024. China's economy has posted strong gains, supported by government policies. Equity prices have fallen and bond yields have eased on market expectations of weaker North American growth. Oil prices have been volatile and are trading below the assumptions in the Bank's January *Monetary Policy Report* (MPR). The Canadian dollar is broadly unchanged against the US dollar but weaker against other currencies.

Canada's economy grew by 2.6% in the fourth quarter of 2024 following upwardly revised growth of 2.2% in the third quarter. This growth path is stronger than was expected at the time of the January MPR. Past cuts to interest rates have boosted economic activity, particularly consumption and housing. However, economic growth in the first quarter of 2025 will likely slow as the intensifying trade conflict weighs on sentiment and activity. Recent surveys suggest a sharp drop in consumer confidence and a slowdown in business spending as companies postpone or cancel investments. The negative impact of slowing domestic demand has been partially offset by a surge in exports in advance of tariffs being imposed.

Employment growth strengthened in November through January and the unemployment rate declined to 6.6%. In February, job growth stalled. While past interest rate cuts have boosted demand for labour in recent months, there are warning signs that heightened trade tensions could disrupt the recovery in the jobs market. Meanwhile, wage growth has shown signs of moderation.

Inflation remains close to the 2% target. The temporary suspension of the GST/HST lowered some consumer prices, but January's CPI was slightly firmer than expected at 1.9%. Inflation is expected to increase to about 2½% in March with the end of the tax break. The Bank's preferred measures of core inflation remain above 2%, mainly because of the persistence of shelter price inflation. Short-term inflation expectations have risen in light of fears about the impact of tariffs on prices.

While economic growth has come in stronger than expected, the pervasive uncertainty created by continuously changing US tariff threats is restraining consumers' spending intentions and businesses' plans to hire and invest. Against this background, and with inflation close to the 2% target, Governing Council decided to reduce the policy rate by a further 25 basis points.

Monetary policy cannot offset the impacts of a trade war. What it can and must do is ensure that higher prices do not lead to ongoing inflation. Governing Council will be carefully assessing the timing and strength of both the downward pressures on inflation from a weaker economy and the upward pressures on inflation from higher costs. The Council will also be closely monitoring inflation expectations. The Bank is committed to maintaining price stability for Canadians.

Information note

The next scheduled date for announcing the overnight rate target is April 16, 2025. The Bank will publish its next full outlook for the economy and inflation, including risks to the projection, in the MPR at the same time.

Source: Bank of Canada

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