Bank of Canada Preview

Economics and Strategy

July 24, 2025

Stuck in neutral… for how long?

By Taylor Schleich

- For a third straight meeting, the Bank of Canada will leave the overnight target unchanged at 2.75%, the middle of its estimated neutral range. Unlike the prior two decisions, there's little doubt about this one, as OIS markets discount sub-10% easing odds.
- Those who had earlier been expecting a cut in July, us included, were dealt a blow this month when hiring was reported to have surged in June and underlying inflation failed to moderate. The closely watched *Business Outlook Survey* was hardly upbeat but still-soft sentiment is insufficient to compensate for firm core inflation and strong job growth. Inflation *expectations* improved but remain a bit high.
- There's growing momentum around the idea that the easing cycle is over. We disagree and we don't expect Governing Council to validate this more hawkish view. Instead, they're likely to keep guidance unchanged, reiterating that they're proceeding carefully and monitoring the same four indicators: export demand; tariff impacts on investment, employment and spending; inflation; and inflation expectations.
- Assuming their data dependent stance is reaffirmed, we don't expect a material rate reaction post-decision. Markets will likely continue pricing less than one cut this year, *for now*.
- This decision will bring with it a new *Monetary Policy Report* which we *hope* will contain a central economic projection, rather two "illustrative scenarios" as presented in April. Policymakers have said we're closer to the less disruptive scenario which could mean the growth forecasts published are stronger than our own.

Perspective on recent Bank of Canada rate decisions

Last five BoC rate decisions and intra-day market reaction

Decision	Change	Rate	2Y yield	2Y: CA-US	10Y yield	CADUSD
Date	*bps*	*%*	*bps*	*bps*	*bps*	*%*
30-Jul-25	**0**	**2.75**	-	-	-	-
04-Jun-25	0	2.75	-1.2	2.9	-1.6	0.2
16-Apr-25	0	2.75	1.6	1.0	1.0	0.3
12-Mar-25	-25	2.75	7.6	8.0	3.7	0.0
29-Jan-25	-25	3.00	-1.0	-3.7	1.4	0.3
11-Dec-24	-50	3.25	8.5	6.4	7.4	0.4

Source: NBC, BoC | Note: Intraday changes based on price/yield at 9:30AM and 12:00PM

How are the BoC's latest forecasts shaping up?

BoC and NBC forecasts for real GDP growth and CPI inflation

	Projection	Q4:24	Q1:25	Q2:25	2025	2026
Real GDP	January MPR	1.8	2.0	-	1.8	1.8
	April MPR*	2.6	1.8	-1.3 | 0.0	0.8 | 1.6	-0.2 | 1.4
	NBC/Actual	2.1	2.2	-0.5	1.3	1.1
CPI inflation	January MPR	1.9	2.1	-	2.3	2.1
	April MPR*	1.9	2.4	1.5 | 1.5	2.0 | 1.8	2.7 | 2.0
	NBC/Actual	1.9	2.3	1.8	1.9	2.0

Source: NBC, BoC | Note: Figures are Y/Y except for quarterly GDP which is Q/Q SAAR.
**April's MR contained two scenarios with large and small trade disruptions.*

In its last two rate decisions, the Bank of Canada has opted for an ultra-data dependent stance, identifying specific criteria that will guide monetary policy: *"Governing Council is proceeding carefully, with particular attention to the risks and uncertainties facing the Canadian economy. These include:*

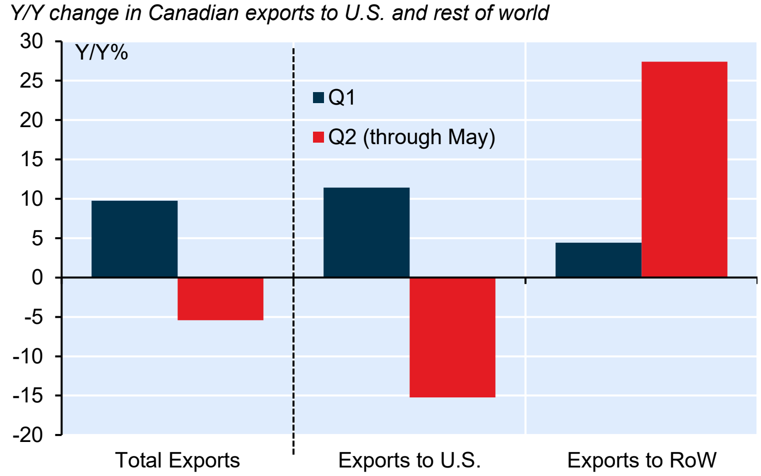
i. the extent to which higher US tariffs reduce demand for exports;
ii. how much this spills into investment, employment and spending;
iii. how much/quickly cost increases are passed onto consumer prices;
iv. how inflation expectations evolve."

We expect this guidance to be reaffirmed on Wednesday which makes going through their "checklist", with a view to the rate outlook beyond July, a worthwhile exercise.

i. Exports down but not out: Exports to the U.S. surged in Q1 as American firms loaded up before tariffs were imposed. Unsurprisingly, U.S.-bound shipments have subsequently collapsed. Canadian businesses have been able to find *partial* offsets in other parts of the world but that's not been enough to make up for less U.S. trade. While we see the outlook for Canadian exports as negative, the BoC is likely to retain the view that "more data [are] needed to determine the extent and persistence" of slower trade. Of course, a trade agreement would help address uncertainty but as has been clear in recent 'deals' with other nations, U.S. protectionism will not be fully dialed back which leaves Canada's export outlook still somewhat challenged.

Canadian exporters have found a *partial* offset to U.S. void

Y/Y change in Canadian exports to U.S. and rest of world



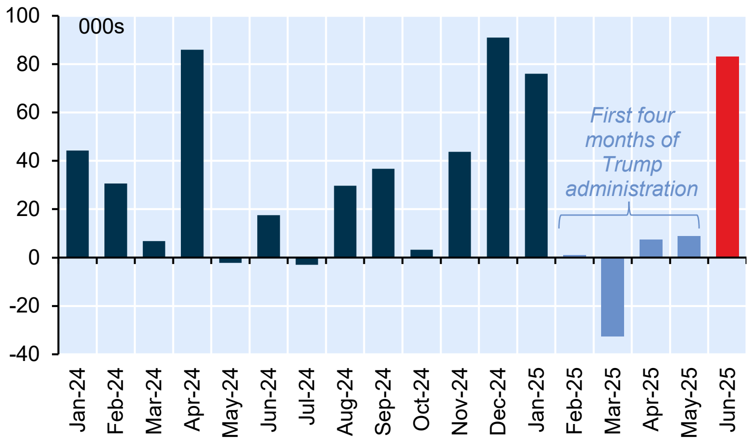
Source: NBC, BBG | Note: RoW = Rest of world.

ii. Fade the June jobs report: The lagged nature of GDP data means the business investment and consumer spending picture beyond Q1 is incomplete but indications, based on hard and soft data, are not particularly robust. Monthly sectoral data imply GDP will modestly contract in Q2, while the recent Business Outlook Survey and Canadian Survey of Consumer Expectations suggests that softness will continue.

Business investment is being put on hold while consumers say they'll be *reducing* spending over the next year. When it comes to employment, June's surprisingly strong *Labour Force Survey* appeared to cast the job market outlook in an entirely different light. However, we were skeptical at the time and remain so given that the hiring surge is inconsistent with other data. Job vacancies are low and still falling, while hiring intentions in the BOS remained muted. We're fading last month's strength and expect further increases in the unemployment rate ahead.

Hiring surged in June, according to the LFS…

Canada monthly employment change



Source: NBC, StatCan

…which is inconsistent with measures of labour demand

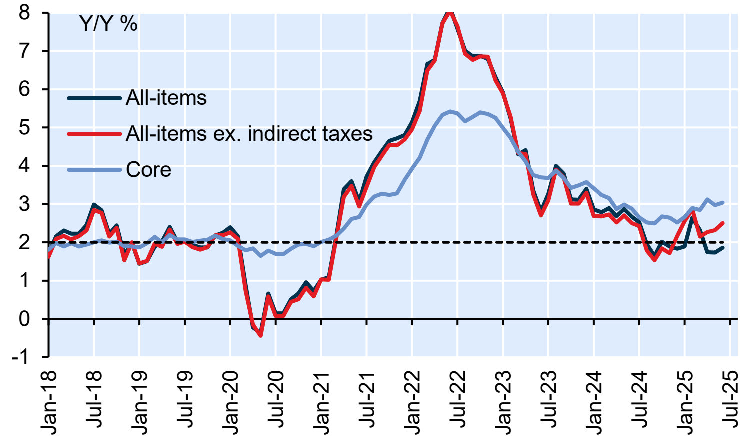
Net hiring plans next 12 months (L), job vacancy rate (R)

Source: NBC, BoC, StatCan | Note: Dotted line = 2010-19 avg. (L) and 2018-19 avg. (R)

iii. Core inflation pressures persist but relief to come: It's still too early to gauge the inflation impact of turbulent trade policy but for now, recent CPI data is not giving the central bank the green light to cut. Headline inflation may look benign but that's due to the elimination of the consumer carbon tax. Excluding taxes, the CPI was up 2.5% in June and core is even hotter at 3%. We'd note that annual inflation is still being disproportionately boosted by shelter and it's clear there's relief in the pipeline here. A growing output gap should help keep prices contained elsewhere. When it comes to tariffs, surveys of Canadian businesses identify new cost pressures but competition and weak demand are limiting their ability to pass these costs on. Wages are also unlikely to be a source of inflation as planned pay increases are back to pre-pandemic levels. Ultimately, we're less anxious about the Canadian inflation outlook and see prices rising in line with the 2% target. However, a data dependent BoC will need to see it to believe it. Specifically, some moderation in their preferred core measures will be a prerequisite for restarting the easing cycle.

Underlying inflation is not giving the green light to cut

Measures of Canadian inflation

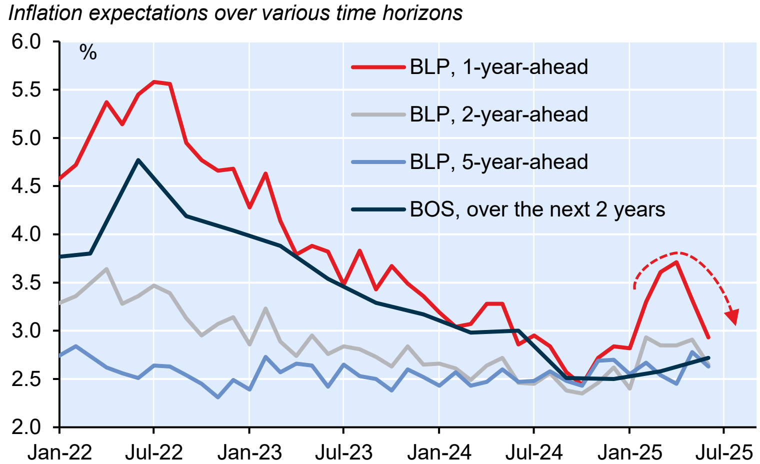


Source: NBC, StatCan | Note: Core = average of CPI-median and CPI-trim.

iv. Inflation expectations are less problematic: Measured inflation in Canada is a bit high and so too is *expected* inflation. The good news is that those expectations have cooled of late. The Q2 BOS revealed that expected price increases over the next year fell to 2.9% from the 3.7% expected during peak tariff chaos. Longer-term expectations are *slightly* higher vs. a year ago but remain anchored within the Bank's target range. Overall, we don't see this item as overly problematic and is less of an obstacle to further rate relief than inflation itself.

Short-run inflation expectations are moderating

Inflation expectations over various time horizons



Source: NBC, BoC | Note: BLP = Business Leaders' Pulse. BOS = Business Outlook Survey.

Bottom Line: Recent data, in light of the BoC's data dependent stance, renders a July cut extremely unlikely. Still, there are signs that Canada's economy will underwhelm in the months ahead as businesses and consumers tread cautiously. Trade impacts may not be as bad as feared but exports are unlikely to be a reliable source of growth. A trade 'deal' with the U.S. would be helpful to address uncertainty but an agreement will still involve material protectionism and is unlikely to return the economy to its pre-Trump growth path. Marginal government spending will be a partial offset but fiscal policy is still uncertain (which probably strengthens the case for the BoC to be patient for now). Ultimately though, it's inflation that's in the driver's seat when it comes to discounting future rate decisions. To us, the disinflationary pressures associated with marginal economic slack will outweigh tariff-related cost pressures which should keep all-items CPI contained and moderate core inflation. Our outlook is consistent with the BoC coming off the sidelines again and with very little easing priced, a bet on further cuts offers an attractive risk-reward profile.

Latest policy statement: June 4, 2025

Bank of Canada holds policy rate at 2¾%

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

Since the April Monetary Policy Report, the US administration has continued to increase and decrease various tariffs. China and the United States have stepped back from extremely high tariffs and bilateral trade negotiations have begun with a number of countries. However, the outcomes of these negotiations are highly uncertain, tariff rates are well above their levels at the beginning of 2025, and new trade actions are still being threatened. Uncertainty remains high.

While the global economy has shown resilience in recent months, this partly reflects a temporary surge in activity to get ahead of tariffs. In the United States, domestic demand remained relatively strong but higher imports pulled down first-quarter GDP. US inflation has ticked down but remains above 2%, with the price effects of tariffs still to come. In Europe, economic growth has been supported by exports, while defence spending is set to increase. China's economy has slowed as the effects of past fiscal support fade. More recently, high tariffs have begun to curtail Chinese exports to the US. Since the financial market turmoil in April, risk assets have largely recovered and volatility has diminished, although markets remain sensitive to US policy announcements. Oil prices have fluctuated but remain close to their levels at the time of the April MPR.

In Canada, economic growth in the first quarter came in at 2.2%, slightly stronger than the Bank had forecast, while the composition of GDP growth was largely as expected. The pull-forward of exports to the United States and inventory accumulation boosted activity, with final domestic demand roughly flat. Strong spending on machinery and equipment held up growth in business investment by more than expected. Consumption slowed from its very strong fourth-quarter pace, but continued to grow despite a large drop in consumer confidence. Housing activity was down, driven by a sharp contraction in resales. Government spending also declined. The labour market has weakened, particularly in trade-intensive sectors, and unemployment has risen to 6.9%. The economy is expected to be considerably weaker in the second quarter, with the strength in exports and inventories reversing and final domestic demand remaining subdued.

CPI inflation eased to 1.7% in April, as the elimination of the federal consumer carbon tax reduced inflation by 0.6 percentage points. Excluding taxes, inflation rose 2.3% in April, slightly stronger than the Bank had expected. The Bank's preferred measures of core inflation, as well as other measures of underlying inflation, moved up. Recent surveys indicate that households continue to expect that tariffs will raise prices and many businesses say they intend to pass on the costs of higher tariffs. The Bank will be watching all these indicators closely to gauge how inflationary pressures are evolving.

With uncertainty about US tariffs still high, the Canadian economy softer but not sharply weaker, and some unexpected firmness in recent inflation data, Governing Council decided to hold the policy rate as we gain more information on US trade policy and its impacts. We will continue to assess the timing and strength of both the downward pressures on inflation from a weaker economy and the upward pressures on inflation from higher costs.

Governing Council is proceeding carefully, with particular attention to the risks and uncertainties facing the Canadian economy. These include: the extent to which higher US tariffs reduce demand for Canadian exports; how much this spills over into business investment, employment and household spending; how much and how quickly cost increases are passed on to consumer prices; and how inflation expectations evolve.

We are focused on ensuring that Canadians continue to have confidence in price stability through this period of global upheaval. We will support economic growth while ensuring inflation remains well controlled.

Information note

The next scheduled date for announcing the overnight rate target is July 30, 2025. The Bank will publish its next MPR at the same time.

Source: Bank of Canada

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