

## European Rates Alpha

## Pay UK rates vs Canada in front-end

**BoE and BoC 2024 rate cut pricing: too similar**

**We recommend selling Dec 2024 BoE MPC-dated Sonia against Dec 2024 BoC MPR-dated CORRA OIS. We enter at 14bp, targeting 75bp with a stop of -25bp.**

The market prices almost identical 2024 rate cutting cycles in the UK and Canada. This is sharp contrast with our own read of the two economies (Exhibit 1). Both stand out also when compared to other major economies: too much is priced in the UK versus our econ baseline of 50bp of cuts and too little in Canada relative to our call for 125bp of cuts (Exhibit 2). Risks to the trade are upside in Canadian shelter prices, wage growth and/or inflation expectations versus a more substantial downturn in the UK, perhaps as rate hikes bite particularly in the corporate sector.

**BoE cut pricing seems like a “best-case” scenario...**

For us, last week's message from the BoE was clear: the Bank used votes, forecasts, guidance and the press conference to push back against market pricing of early and fast cuts ([Bank of England review: message loud and clear](#), 1 Feb). But the rates market still chose to focus on the more dovish elements of the meeting, for example the removal of the hiking bias and Governor Bailey acknowledging that keeping rates unchanged would push inflation “significantly” below the target of 2%. The global risk off momentum proved a timely tailwind for the doves in the market. However, bar a substantial downturn, we remain confident that the UK will be the last major central bank to start cutting rates and is likely to move more slowly. The UK still has a bigger persistent inflation problem, despite recent improvements. We expect the BoE to stay on hold at 5.25% until August and cut twice (50bp in total) in 2024. We see market pricing of 75-100bp of cuts as the best-case scenario (Exhibit 3).

**... while risks skew towards earlier BoC cuts**

Like last week's message from the BoE, the BoC dropped its hiking bias in January, signalling that cuts are not imminent by noting that it needs to see “further and sustained easing in core inflation”. Our economists believe the first cut will happen in June as the BoC will likely wait until core inflation and wage growth shows a clear downward trend ([BoC drops hiking bias, next movement is a cut \(likely in June\)](#), 24 Jan). However, the Canadian economic activity is already in contraction and the labour market is showing signs of easing, posing the risk that the BoC decides to change its language in March and cut in April (we believe that the structure of the Canadian mortgage market is the ultimate cause of the deceleration amid tight monetary policy, see [Weak economy to drive BoC cuts in 2024](#), 4 Dec). Our base case is five 25bp cuts in 2024. The market pricing of around 85bp suggests scope for Canadian rates outperformance (Exhibit 4).

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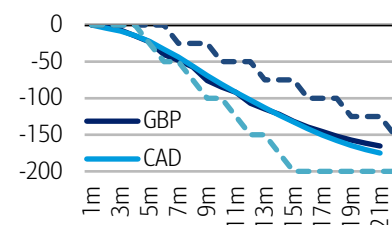
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**Abbreviations:**

CORRA: Canadian Overning Repo Rate Average  
MPC: Monetary Policy Committee  
MPR: Monetary Policy Report  
BoE: Bank of England  
BoC: Bank of Canada

For open trades, and closed trades over the past 12 months, please see the latest [Global Rates Weekly](#) report published on 2 Feb.

**Exhibit 1: Cum. cuts priced in next 21m**  
BoE cut pricing matches BoC's very closely



**Source:** BofA Global Research.  
Dashed lines show BofA forecast.

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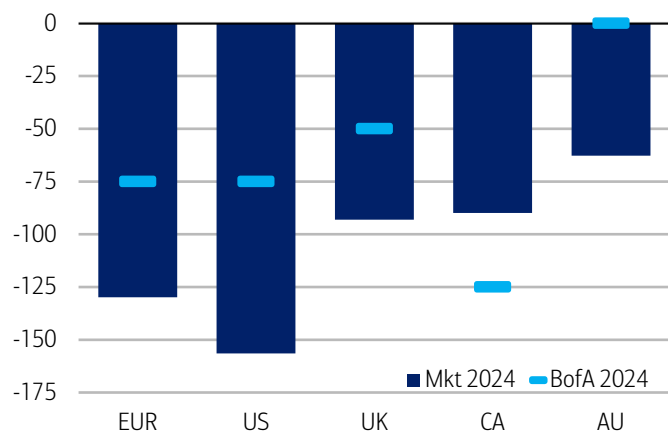
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## Other ways to trade UK-CA rate cut divergence

We fade the BoE cuts priced for 2024 against rate cut pricing in Canada using respective Dec 2024 meeting-dated swap contracts but acknowledge that liquidity in those longer dated contracts can still be limited. Dec 2024 3m futures are one alternative, but 2y OIS can also be considered as well as 2y bonds. Further out, the 1y OIS gap curve troughs at 2.9% (3y fwd 1y) in Canada and at 3.3% (4y fwd 1y) in the UK (Exhibit 5). While the BoC judges that nominal neutral policy rate is between 2-3%, the BoE has been very cautious in quantifying a specific neutral level for Bank Rate in the past. With the higher trough in the UK curve, the UK-CA cross market position appears less attractive beyond the 2-3y.

### Exhibit 2: Implied cuts in 2024 (from spot) vs. BofA baseline

Canada and UK stand out among major global central bank peers

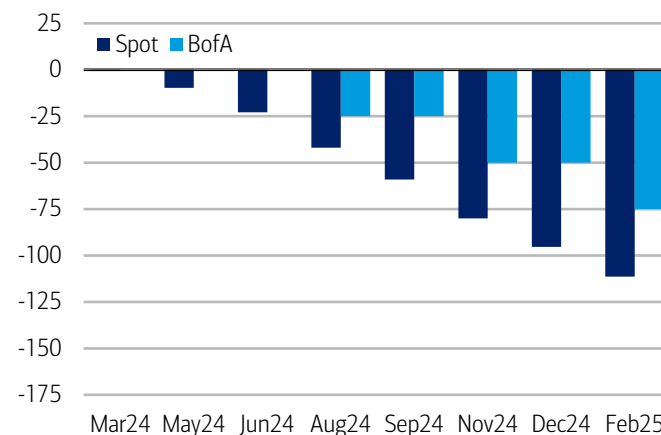


Source: BofA Global Research

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### Exhibit 3: BoE MPC-dated Sonia rate cut exp. vs. BofA f'casts, bp

We expect BoE to cut less than currently implied by the market...

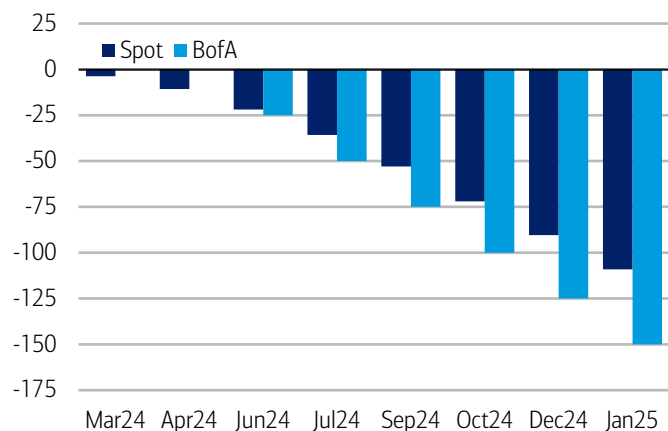


Source: Bloomberg, BofA Global Research

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### Exhibit 4: BoC MPR-dated CORRA OIS rate cut exp. vs. BofA f'casts, bp

... the opposite is true when it comes to Bank of Canada

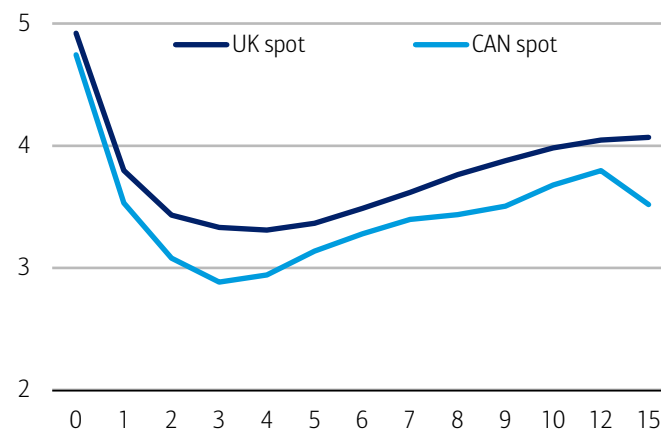


Source: Bloomberg, BofA Global Research

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### Exhibit 5: OIS 1y gap forwards curve, %

OIS 1y gap curve troughs at 2.9% in Canada and at 3.3% in the UK



Source: BofA Global Research

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