

Canada Economics Comment: BoC Holds Rates; Maintaining a 2.25% Terminal Rate Forecast

BOTTOM LINE: The BoC held the policy rate at 2.75% today, in line with consensus expectations and market pricing but against our forecast for a 25bp cut. The statement's characterization of the economy was more hawkish than expected, emphasizing the resilience of consumption and employment outside of those sectors directly affected by tariffs, and the opening press conference statement from Governor Macklem noted a "clear consensus to hold policy unchanged" at today's meeting. That said, the opening press conference statement also added that the Governing Council thought that "there could be a need for a reduction in the policy rate if the economy weakens in the face of continued US tariffs and uncertainty, and cost pressures on inflation are contained". The Governing Council maintained a data-dependent stance, and we expect further rate cuts to hinge on spot data. Given our forecast for weaker activity in Q2 and Q3, we maintain our forecast for two more 25bp rate cuts in 2025 (now July and October vs. June and July previously) and a 2.25% terminal rate, but acknowledge that emphasis on volatile spot data raises uncertainty around the extent and timing of further cuts.

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KEY NUMBERS:

Policy rate: 2.75% (2.75% prior); GS: 2.50%; median forecast: 2.75%

MAIN POINTS:

1. The BoC held the policy rate at 2.75% today, in line with consensus expectations and market pricing, but against our forecast for a 25bp cut.
2. Today's decision statement and press conference noted the "resilience" of the Canadian economy in the face of trade tensions thus far, emphasizing that consumption continued to grow in Q1—albeit at a slower pace than at the end of 2024—and that business investment grew by more than expected. The characterization of the economy was more hawkish than we expected, with the decision statement describing the composition of the Q1 print as "largely as expected" despite softer consumption and investment than forecasted. However, Governor Macklem also noted that "the second quarter is expected to be much weaker" as the frontloading of exports and inventory accumulation in Q1 implies weaker subsequent growth and emphasized that the drag on growth would be larger if current levels of uncertainty persist.
3. The decision statement noted the increase in the unemployment rate to 6.9% and that the labor market had weakened. However, the opening statement to the

press-conference also emphasized that “so far, employment has held up across sectors that are less exposed to trade”, suggesting broader evidence of labor market weakness may be necessary for further easing.

4. The characterization of inflation was also somewhat hawkish. The decision statement noted that, excluding taxes, inflation was “slightly stronger than the Bank had expected” at +2.3%. In the press conference, Macklem noted that the preferred core measures ticked up, as did other inflation measures in April, in particular emphasizing the share of products running above a 3% rate. Furthermore, the opening statement stated that “it is still too soon to see the direct effects of retaliatory tariffs in consumer price data”, and instead stressed the indirect effects of higher costs associated with searching for new suppliers and end markets. While the statement acknowledged the “unusual volatility in inflation”, Governing Council ultimately concluded that “underlying inflation could be firmer than [they] thought”.

5. We had expected that the Governing Council would view the accumulated evidence of weaker growth as sufficient to prompt a 25bp cut at today’s meeting (despite the somewhat firmer inflation), especially given forecasts for weaker activity due to continued headwinds from US tariffs. Instead, the BoC decided to remain “less forward looking than usual” in setting policy, suggesting that future policy easing will be contingent on the realization of weaker growth and better inflation data. Furthermore, the characterization of the composition of Q1 GDP as “largely as expected” and the view that it “is still too soon to see the direct effects of retaliatory tariffs” was hawkish relative to our expectations of how the BoC would interpret recent data.

7. Despite the relatively hawkish message and noting a “clear consensus to hold policy unchanged” at today’s meeting, the opening press conference statement from Governor Macklem also included new language that the Governing Council thought that “there could be a need for a reduction in the policy rate if the economy weakens in the face of continued US tariffs and uncertainty, and cost pressures on inflation are contained”. We see this statement as signalling a willingness to cut further, although further easing will hinge on spot data. Given our forecast for activity to remain weak in Q2 and Q3, we are maintaining a forecast for two more rate cuts in 2025 (now July and October vs. June and July previously) and a 2.25% terminal rate, but acknowledge that the emphasis on volatile spot data raises uncertainty around the extent and timing of further cuts.

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