Economic Update

June 5, 2024

BoC starts to move interest rates lower

- The Bank of Canada cut its key overnight rate by 25 basis point to 4.75% – the first reduction in four years and after holding the key policy rate at 5% since last hiking rates in July 2023. The move was not a surprise with markets pricing roughly 75% odds of a cut before the announcement.
- The reduction today marked the beginning of the central bank easing monetary policy towards more 'normal' levels of interest rates after a prolonged and difficult battle with rising inflation pressures. That still, however, leaves monetary policy firmly in 'restrictive' territory – the change in interest rates today is the equivalent of the central bank easing off the brakes rather than stepping on the gas.
- Today's pivot is entirely possible because of persistently lower inflation readings over the last year. The BoC's core CPI measures, the CPI trim, CPI median and "supercore" started to ease more significantly in 2024 and averaged at 1.85% on a three-month annualized basis at last count in April. That alongside currently soft economic backdrop argued strongly that "monetary policy no longer needs to be as restrictive."
- The BoC in its statement also highlighted ongoing softening in labour market conditions as growth in employment lags that of the working age population, and pointed to wage pressures "that look to be moderating gradually".
- Moving forward and similar to our own forecast, the BoC expects unwinding in price pressures will persist, especially with the Canadian economy still running in excess supply (demanding less than what's produced). The BoC's forecast per the April Monetary Policy Report is for headline CPI to continue to trend lower and reach the 2% target in 2025, despite improving economic outlook in the meantime.
- With the first interest rate cut now out of the way, the focus will shift towards the pace and amount of further rate cuts. On that front, the BoC offered few clues outside of reiterating that upside inflationary risks still remain, and decisions will be made "one meeting at a time". Our own

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expectation remains that there will be three more rate cuts this year to lower the overnight rate to a still restrictive 4% by the end of 2024.

- **Bottom line:** The rate cut today from the Bank of Canada marks the first step of an easing cycle where interest rates are lowered back towards “normal” levels, and spells good news for Canadian households that have been contending with elevated borrowing costs. To be sure, interest rates themselves are still high – and will still be at levels the BoC views as ‘restrictive’ by the end of this year even if our expected 100 bps worth of cuts materialize. Still, the move itself signifies confidence among policymakers that the most likely path for future inflation in Canada is down. The BoC will get two additional monthly inflation and labour market reports, as well as the second quarter business and consumer surveys before the next scheduled policy decision in July. Those should all offer more clues on a few key pressures points that the BoC highlighted including housing, wage growth and inflation itself. Our own base case assumes another 25 basis point cut in July.