

ECONOMIC RESEARCH AND STRATEGY



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Bank of Canada June Decision — Time to Reduce the Degree of Restrictiveness of Monetary Policy

There was a clear shift in mindset within the walls of the BoC since the delivery of the April decision. Increased confidence that inflation is on a firm cooling path led the BoC to cut the overnight rate target by 25 basis points to 4.75%. 4.75% is still restrictive. Relative to where total CPI and core CPI inflation sit, staying at 5% would have increased the risk of overtightening and harming economic activity. As such, the BoC is beginning an atypical monetary easing cycle considering how elevated the degree of restrictiveness of monetary policy is.

BoC officials are confident that total CPI inflation (at 2.7% in April) will converge to the comforting 3-month annualized % change in the two core inflation metrics below 2% (median: 1.5%; trim: 1.8%). We agree. Accordingly, the BoC was able to send a new forward guidance message to savers, borrowers, and lenders: *“it is reasonable to expect further cuts to our policy interest rate”*. This path could take the form of two more 25 basis points cuts this year and 2-3 additional ones in 2025H1. At the same time, the BoC is careful not to go on autopilot with 25 basis points cuts at each of the remaining four meetings of 2024. The BoC is *“taking our interest rate decisions one meeting at a time”*. With such a data-dependant approach, the BoC will try to prevent an overreaction from businesses and consumers. Both must not misleadingly dream about a 2%-3% overnight rate target and 3%-4% fixed mortgage rates. For instance, a slightly higher % share of Canadians than average plan to buy a home in the next 12 months, according to the BoC Survey of Consumer Expectations. Real estate overbidding could spark an appreciation in home prices, feeding into the CPI shelter component of total CPI, the last thing the BoC wants to see.

Our economic team currently tracks a 0.1%-0.2% month-over-month mild increase for the May total CPI figure (to be released on June 25th). Also, the June CPI report will be released before the next BoC meeting on July 24th. As such, it appears reasonable for financial markets to price in another cut at the July meeting but not necessarily for the September 4th meeting.

Even if the BoC can reduce the degree of restrictiveness in the quarters ahead, the overnight rate target is poised to ultimately sit at a higher trough than in previous easing cycles. Forceful supply-driven inflation in this world of global fragmentation and climate shocks requires tapering off more than before demand-driven inflation with higher interest rates. As such, we think total CPI inflation is relatively high given the soft pulse of Canadian economic momentum observed lately and the current moderate slack in the domestic economy.

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