Laurentian Bank Securities
ECONOMIC RESEARCH AND STRATEGY

BoC Decision – Global Trade Tensions Could Bring the BoC Closer to Rate Cuts

The Bank of Canada (BoC) left the overnight rate target unchanged at 1.75% today.

Financial markets perceived dovish language from the statement and the new July *Monetary Policy Report* (*MPR*). Clearly, persistent trade headwinds on economic growth and commodity prices are front and center. For instance, the BoC estimates that tariffs and related uncertainty will shave a large 0.6pp from global real GDP by the end of 2021, up from the 0.4pp estimate used in the April *MPR*. Granted, it is difficult to assess the impact of the escalation in trade conflicts and the record-high uncertainty in global economic policies on economic activity. For instance, the BoC mentions in the *MPR* the complex adjustment of global supply chains caused by tariffs. Also, let us mention that a growing number of companies could delay capex spending and hiring decisions, which would ultimately reinforce the ongoing economic slowdown.

This being said, the Canadian economic outlook has not sufficiently deteriorated to push the BoC to signal rate cuts for the summer or next fall. It appears the BoC would need to see greater-than-expected negative implications of the recent trade developments, or further worsening in trade tensions, to cement the case for additional monetary easing. Furthermore, global and domestic financial conditions have eased already. The Fed and ECB have been doing the heavy lifting by signaling “insurance” rate cuts. This so-called insurance cut is not an option the BoC seems to consider, particularly since 5-year mortgage rates in Canada have declined during the first half of 2019 due to the fall in bond yields observed in other major countries. Furthermore, Canadian CPI inflation has been sitting close to 2% and is unlikely to dip persistently away from target as real GDP growth is expected to accelerate near 2% in 2020 and 2021. Accordingly, the current policy rate will remain sufficiently accommodative unless economic growth and CPI inflation falter below the *MPR* forecasts.

Bottom Line: As the trade conflicts continue to slow global economic momentum and put a dent in commodity prices, financial markets see that the BoC is moving a notch closer to cutting its policy rate. We prefer to maintain our view that the BoC policy rate will stay at 1.75% throughout 2020 until we all witness trade tensions dissipate or worsen. The BoC is not boxed in like the Fed on rate cuts. This being said, the threshold for a policy rate cut in late 2019 or early 2020 diminished given the somewhat upbeat *MPR* projection of a strengthening in the Canadian economy above potential growth.

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