International Commentary — December 11, 2024

Bank of Canada Delivers Again

Summary

- The Bank of Canada (BoC) delivered a large 50 bps rate cut for the second meeting in a row at today's announcement, lowering its policy rate to 3.25%.
- While acknowledging an overall softening in growth, the BoC's economic assessment was somewhat balanced, noting areas of both strength and weakness within the economy. Against this backdrop, the central bank signaled a more gradual pace of easing going forward, saying rates have already been lowered substantially since June, and that further reductions in the policy rate will be evaluated one decision at a time.
- In our view, today's announcement reflects some front-loading of the BoC's monetary easing plans. Our base case is for the Bank of Canada to cut its policy rate by 25 bps in January, March and April, which would see the policy rate reach a low of 2.50% in Q2-2025, earlier than we previously forecast. The risks are tilted toward further easing, especially if Canadian growth is weaker than expected or U.S. tariff policy is more aggressive than expected.

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Bank of Canada Delivers Large Rate Cut, But Turns Less Dovish

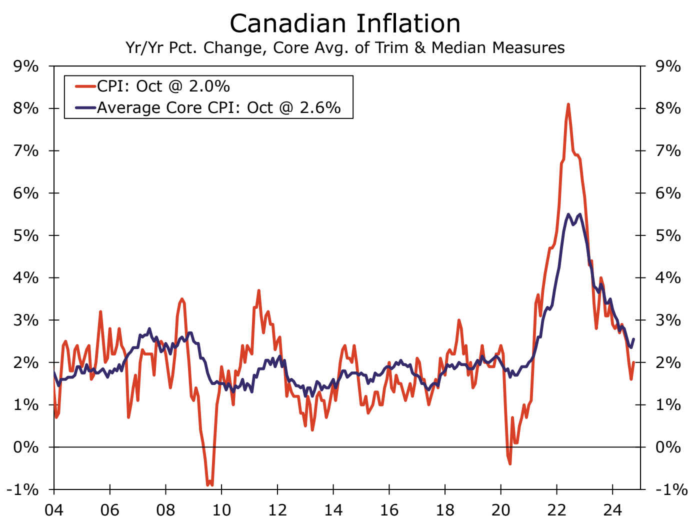
For a second straight meeting, the Bank of Canada delivered a large 50 bps rate cut, taking the policy rate to 3.25%. That decision matched widespread, but not unanimous, expectations. At the same time, the Bank of Canada's move appears to reflect some "front-loading" of its monetary easing plans. We still see the BoC lowering its policy rate to a low of 2.50%, though expect it will reach that level by Q2-2025, earlier than we previously forecast.

Among the key comments accompanying today's decision:

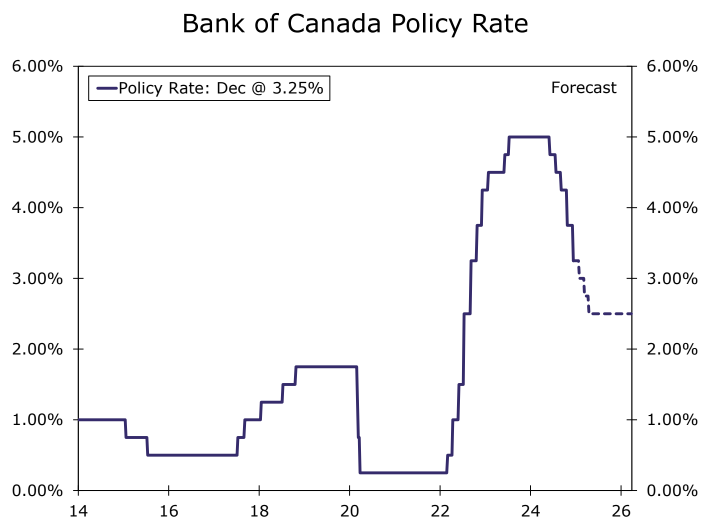
- Canada's Q3 GDP growth pace of 1% was weaker than expected, and Q4 GDP also looks be tracking softer than forecast.
- On the less dovish side, solid consumer spending and a pickup in housing activity suggest lower interest rates are beginning to boost household spending. While wage growth has slowed, it remains elevated relative to productivity.
- On the more dovish side, the BoC noted weak business investment, said lower Canadian immigration could mean lower GDP growth next year, and said the possibility the U.S. will impose new tariffs on Canadian exports has increased uncertainty around the outlook.
- Overall, the Bank of Canada said the economy remains in excess supply and growth appears weaker than projected in October.

In the context of these somewhat balanced comments around the economic outlook, the BoC's guidance was consistent with a more gradual pace of easing going forward. The central bank said it "has reduced the policy rate substantially since June. Going forward, we will be evaluating the need for further reductions in the policy rate one decision at a time. Our decisions will be guided by incoming information and our assessment of the implications for the inflation outlook."

Expanding on this guidance, Governor Macklem also said "monetary policy no longer needs to be clearly in restrictive territory", and that with the policy rate substantially lower "we anticipate a more gradual approach to monetary policy if the economy evolves broadly as expected." One thing the Bank of Canada did not say, yet, was that it sees a need for accommodative monetary policy.



Source: Bloomberg Finance L.P. and Wells Fargo Economics



Source: Bloomberg Finance L.P. and Wells Fargo Economics

Overall, we view today's announcement as reflecting a front-loading of the Bank of Canada's monetary easing plans. With headline inflation at the 2% target and core inflation running only modestly faster, the central bank has flexibility to lower interest rates further, while its guidance suggests those rate cuts will come in smaller 25 bps increments. The BoC's guidance is also consistent with the policy rate being reduced to a neutral range, which the BoC currently estimates as between 2.25% to 3.25%, rather than below that neutral range. Given this guidance, our base case is for the Bank of Canada to cut its policy rate by 25 bps in January, March and April, which would see the policy rate reach a low of 2.50% in Q2-2025. The risks are tilted toward further easing, especially if Canadian growth is weaker than expected or U.S. tariff policy is more aggressive than expected. We also view sluggish economic growth and ongoing Bank of Canada easing as consistent with a weaker Canadian dollar over the medium term. We forecast the USD/CAD exchange rate reaching CAD1.5000 by the end of our forecast horizon in Q1-2026.

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