

April 10, 2024

BoC holds interest rates but confidence building that cuts are coming

- The Bank of Canada held the overnight rate unchanged (as widely expected) for a 6th straight policy decision in April, but is gaining confidence that inflation is on a sustainable path back to the 2% target.
- Stronger GDP data in early 2024 prompted an upgrade to the BoC's economic growth forecast. But with population continuing to surge, the 2.8% increase in Q1 2024 that the BoC now expects still nets out to a seventh consecutive per-capita decline and left the BoC's assessment of the economy-wide output gap in Q1 was 'roughly unchanged' from Q4, at still below zero (-0.5% to -1.5%).
- The BoC also highlighted slower employment growth and a rising unemployment rate as signs the economy is softening and again flagged recent signs that wage pressures are moderating.
- Inflation readings have surprised somewhat on the downside over early 2024 relative to the BoC's prior expectations. The BoC's preferred 'core' CPI measures are running above the top end of the BoC's 1% to 3% target on a year-over-year basis but the policy statement pointed to the more recent 3-month annualized growth rate (2.2% on average for the median and trim measures in March) as further evidence that price growth momentum is slower.
- Moving forward, a negative output gap and higher unemployment rate are all implying that inflation pressures are more likely to (notwithstanding normal monthly volatility) slow rather than rise.
- Governor Macklem confirmed in the press confidence that recent trends on inflation are what the BoC wants to see to justify interest rate cuts. But policymakers just want to see those trends sustained to avoid reacting prematurely to volatile data reports.
- As expected, the BoC updated their estimate of the long-run 'neutral' rate of interest (the interest rate that is consistent in the long-run with their 2% inflation target) by 25 basis points to 2.25% to 3.25%. Governor Macklem was careful to iterate that the estimate of the neutral rate itself has little implications for "real-time monetary policy."
- **Bottom line:** The BoC remains cautious about declaring victory over inflation prematurely, but an underperforming economy relative to other regions (particularly relative to the U.S.) and slowing inflation in recent months is edging policymakers closer to the first cut in interest rates. Governor Macklem was careful not to suggest a cut is imminent quickly, but also did not dismiss the potential for a cut at the next policy meeting in June. The BoC will get two additional monthly inflation reports, and one more monthly labour market report before the next scheduled policy decision and our own base case assumes a 25 basis point cut in June.

Nathan Janzen | Assistant Chief Economist, RBC Economics | Royal Bank of Canada | T. (416) 974-0569
For more economic research, visit our website at <https://thoughtleadership.rbc.com/economics/>

The material contained in this report is the property of Royal Bank of Canada and may not be reproduced in any way, in whole or in part, without express authorization of the copyright holder in writing. The statements and statistics contained herein have been prepared by RBC Economics Research based on information from sources considered to be reliable. We make no representation or warranty, express or implied, as to its accuracy or completeness. This publication is for the information of investors and business persons and does not constitute an offer to sell or a solicitation to buy securities.