WELLS FARGO

International Commentary — June 10, 2024

Bank of Canada Eases Into Monetary Easing

Summary

- The Bank of Canada (BoC) embarked on its monetary easing cycle last week with a widely expected 25 bps policy rate cut, to 4.75%. The accompanying statement was generally dovish in tone, with the central bank saying it was reasonable to expect further rate cuts over time.
- Incoming data indicate relatively steady economic and employment growth during early 2024, while inflationary pressures continue to subside. The BoC itself acknowledged that there is room for growth, even as inflation continues to recede. As a result we expect the Bank of Canada will cut its policy rate 25 bps at its July announcement, while our base case also sees 25 bps rate cuts in September and October, which would see the BoC policy rate end 2024 at 4.00%.
- The risks around our medium-to-longer term BoC policy outlook are tilted toward a more gradual pace of easing. Should Canadian economic activity remain surprisingly resilient and there be an interruption to favorable inflation trends, there is a risk of a renewed BoC monetary policy pause at either the September or October meeting. There also remains the possibility of a further delay to Fed easing which, should it transpire, could be another reason for the BoC to adopt a more cautious approach in lowering its own policy interest rate.

Economist(s)

Nick Bennenbroek
International Economist | Wells Fargo Economics
Nicholas.Bennenbroek@wellsfargo.com | 212-214-5636

Bank of Canada Begins Rate Cut Cycle

In a widely expected move, the Bank of Canada (BoC) last week initiated a rate cut cycle, lowering its policy rate 25 bps to 4.75%. In addition to the rate cut, the accompanying statement was overall dovish in tone. The BoC said:

- Q1 GDP growth was weaker than forecast, although consumption growth was solid
- Employment continues to increase, but growth in jobs continue to lag that of the working age population. Wage pressures remain, but look to be moderating gradually
- Overall, “recent data suggest the economy is still operating in excess supply”

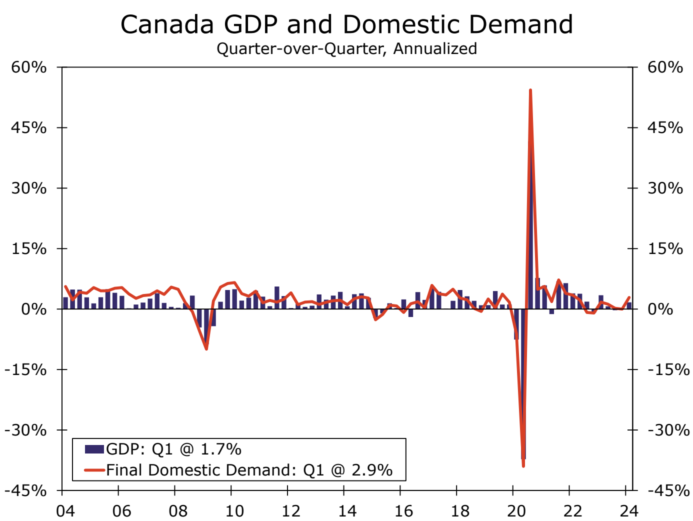
The central bank also noted the slowing in the pace and lessening in the breadth of price increases, and concluded that “monetary policy no longer needs to be as restrictive,” adding that recent data has increased policymakers' confidence that inflation will continue to move toward the 2% target.

Separately, in a post-meeting press conference, BoC Governor Macklem said if “inflation continues to ease, and our confidence that inflation is headed sustainably to the 2% target continues to increase, it is reasonable to expect further cuts to our policy interest rate. But we are taking our interest rate decisions one meeting at a time.” He also said there is room for growth, even as inflation continues to recede.

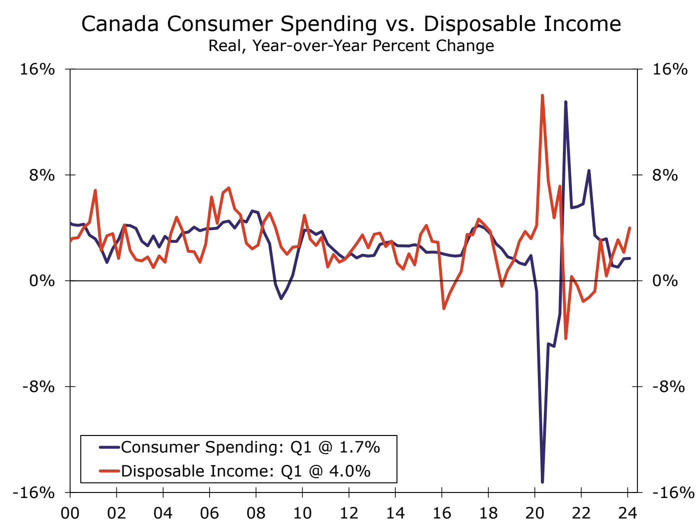
Finally, when asked how much lower Canadian policy interest rates could move below U.S. policy interest rates (to the extent that it contributes to a weaker Canadian dollar and thus local inflationary pressures), Governor Macklem said “I don't think we're close to that limit.” In our view, the Bank of Canada clearly appears comfortable lowering interest rates further, with the key question instead being the pace at which those rate cuts are delivered.

Steady Canadian Economic Trends in Early 2024

In assessing the outlook for Bank of Canada monetary policy over the next several months, our view is that trends in economic growth have been steady enough, while inflation trends have remained generally favorable. Canada's Q1 GDP report was mixed, with GDP growing 1.7% quarter-over-over annualized, less than the 2.2% gain forecast by consensus. Q4 GDP was also revised lower, from a previously reported 1.0% growth pace, to just 0.1%.



Source: Datastream and Wells Fargo Economics

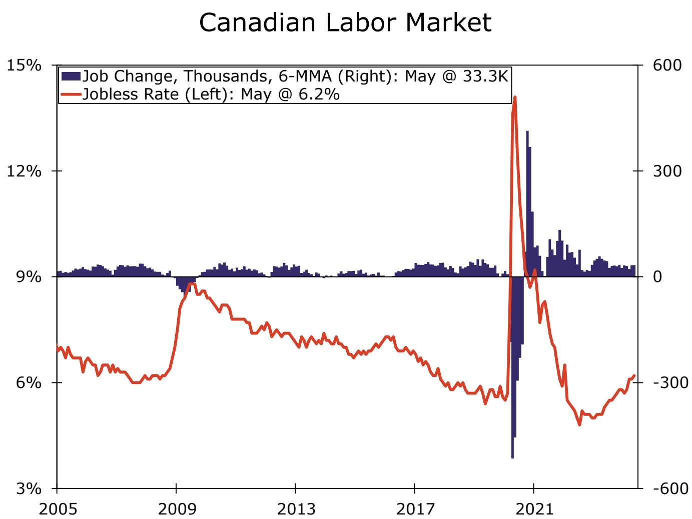


Source: Datastream and Wells Fargo Economics

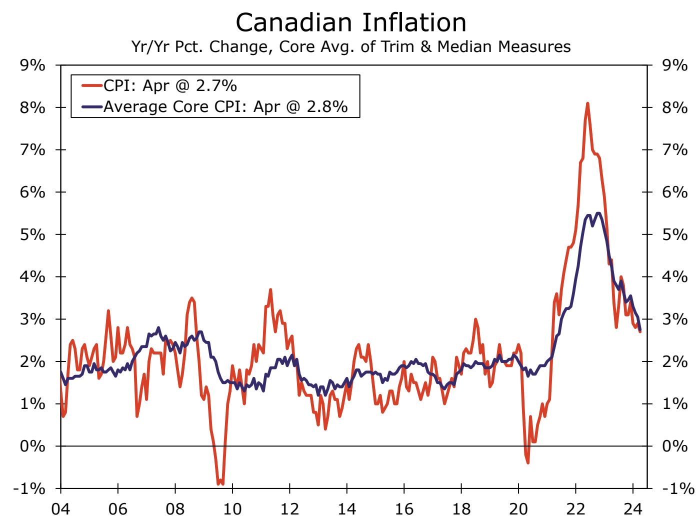
However, while headline figures were disappointing, there were details of the report that were more encouraging. For the first quarter, household consumption grew at a 3.0% pace and final domestic demand grew at a 2.9% pace, indicative of sturdier domestic activity than the headline figure suggests. Details surrounding household finances were also encouraging. We estimate that growth in real household disposable income firmed further to 4.0% year-over-year in Q1, while the household saving rate rose to 6.9% of disposable income. A higher saving rate should be supportive of consumer spending and broader economic growth through 2024, although elevated interest rates and interest costs for consumers will likely still prove to be something of a burden.

Canada's May labor market report suggested the economy maintained some momentum into the second quarter. Employment rose by 26,700 in May, following a surge of 90,400 in April. Over the last six months, employment has risen by a more-than-respectable 33,300 on average. To be fair, the May employment increase was driven entirely by part-time jobs, as full-time jobs fell by 35,600. Overall, growth in employment continues to lag growth in the labor force, meaning the unemployment rate rose further to 6.2% in May. Thus even though wage growth remains elevated—hourly wages for permanent workers rose 5.2% year-over-year in May—a gradual loosening in the labor market could still see a gradual slowing in wage pressures as the year progresses.

As the BoC itself acknowledged, there is room for growth even as inflation continues to recede. We do not believe these relatively steady readings on GDP and employment will, in and of themselves, prevent the Bank of Canada from easing further. That said, should Canadian economic growth fail to moderate as expected ***and*** if inflation trends became less favorable, as least some of the future Bank of Canada rate cuts we anticipate could be at risk.



Source: Datastream and Wells Fargo Economics

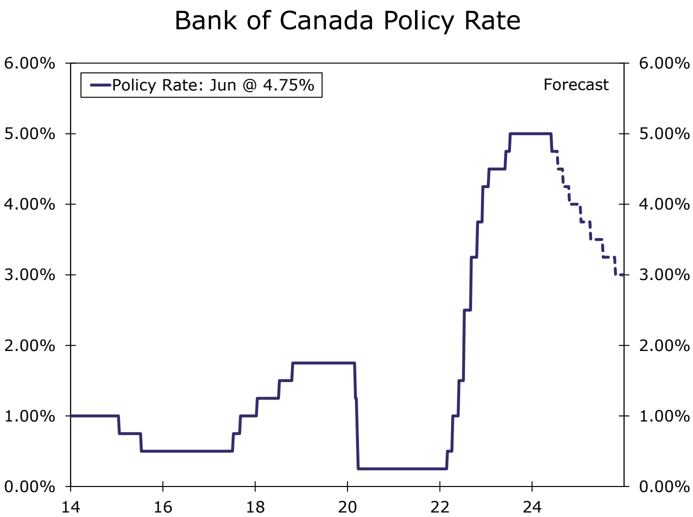


Source: Bloomberg Finance L.P. and Wells Fargo Economics

Encouraging Inflation Trends Means More Monetary Easing to Come

Speaking of inflation, Canada's CPI reports for January through April have pointed to subdued inflationary pressures every month so far this year in 2024. For April, headline inflation slowed to 2.9% year-over-year, while average core inflation also slowed further to 2.8% year-over-year. In fact, when measured over a shorter time horizon, trends in core inflation appear consistent with a further deceleration of inflation pressures in the months ahead. The average core CPI rose at just a 1.6% annualized pace in the three months to April, and a moderate 2.4% annualized pace in the six months to April.

The Bank of Canada's next monetary policy announcement is schedule for 24 July, ahead of which the key data releases should be the May CPI (25 June), June employment (5 July), June CPI (16 July) and, to a lesser extent, April GDP (28 June). So long as underlying inflation continues its subdued trend through May and June, we believe that will give Bank of Canada policymakers enough confidence to deliver another 25 bps policy rate cut to 4.50% at the July meeting. Beyond that, our base case is for the Bank of Canada to also cut rates at its September and October monetary policy meetings, before a pause at the December meeting. In terms of the medium-to-longer term outlook for Canadian monetary policy, we believe the risks are tilted toward a slower pace of rate cuts from the Bank of Canada. In particular, we believe there is a risk of a renewed pause at either the September of October monetary policy announcement. Trends in economic activity have been quite steady at the start of this year and, should growth fail to slow as expected and there be some interruption to the improving inflation trends, the Bank of Canada would, in our view, be likely to shift to a more gradualist approach to monetary easing. We do believe it could take some time for this risk scenario of ongoing sturdy growth and/or less favorable inflation trends to develop, which is why view a renewed pause as more likely in September or October than in July. The outlook for Federal Reserve monetary policy could also have some impact on the longer term outlook for Canadian monetary policy as well. Our current outlook envisages Fed rate cuts in September and December of this year, and continued Fed easing through 2025. However, to the extent Fed easing is further delayed—thereby exacerbating the divergence between Canadian and U.S. monetary policy—that could also be a reason for a renewed Bank of Canada monetary policy pause later in 2024.



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

Subscription Information

To subscribe please visit: www.wellsfargo.com/economicsemail

Via The Bloomberg Professional Services at WFRE

Economics Group

Jay H. Bryson, Ph.D.	Chief Economist	704-410-3274	Jay.Bryson@wellsfargo.com
Sam Bullard	Senior Economist	704-410-3280	Sam.Bullard@wellsfargo.com
Nick Bennenbroek	International Economist	212-214-5636	Nicholas.Bennenbroek@wellsfargo.com
Tim Quinlan	Senior Economist	704-410-3283	Tim.Quinlan@wellsfargo.com
Sarah House	Senior Economist	704-410-3282	Sarah.House@wellsfargo.com
Azhar Iqbal	Econometrician	212-214-2029	Azhar.Iqbal@wellsfargo.com
Charlie Dougherty	Senior Economist	212-214-8984	Charles.Dougherty@wellsfargo.com
Michael Pugliese	Senior Economist	212-214-5058	Michael.D.Pugliese@wellsfargo.com
Brendan McKenna	International Economist	212-214-5637	Brendan.Mckenna@wellsfargo.com
Jackie Benson	Economist	704-410-4468	Jackie.Benson@wellsfargo.com
Shannon Grein	Economist	704-410-0369	Shannon.Grein@wellsfargo.com
Nicole Cervi	Economist	704-410-3059	Nicole.Cervi@wellsfargo.com
Patrick Barley	Economic Analyst	704-410-1232	Patrick.Barley@wellsfargo.com
Jeremiah Kohl	Economic Analyst	212-214-1164	Jeremiah.J.Kohl@wellsfargo.com
Aubrey George	Economic Analyst	704-410-2911	Aubrey.B.George@wellsfargo.com
Delaney Conner	Economic Analyst	704-374-2150	Delaney.Conner@wellsfargo.com
Anna Stein	Economic Analyst	212-214-1063	Anna.H.Stein@wellsfargo.com
Coren Burton	Administrative Assistant	704-410-6010	Coren.Burton@wellsfargo.com

Required Disclosures