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Chart 1

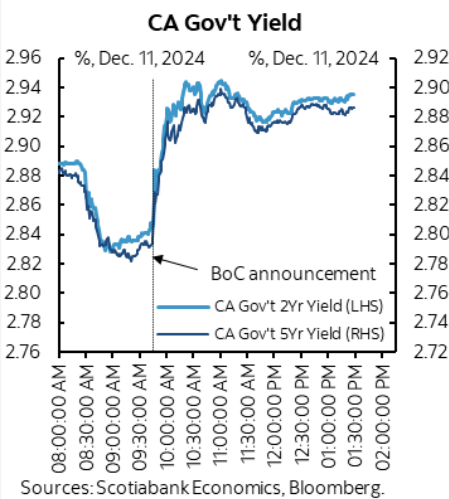
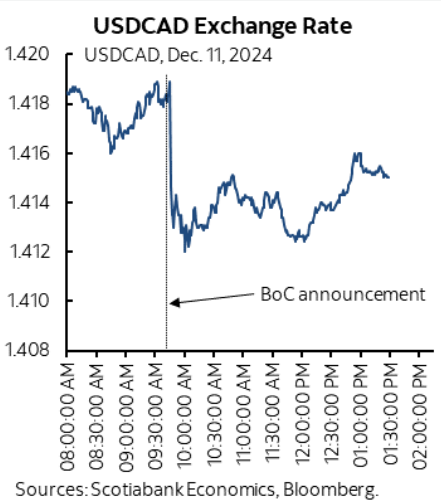


Chart 2



The BoC Cut 50bps—and Borrowing Costs Moved Up

- The BoC cut its policy rate by 50bps as expected...
- ...and left balance sheet plans unchanged
- Waffling on the path forward reduced market pricing for further easing
- Macklem rebuked Poloz's claim
- BoC signals it may be at neutral now
- The BoC is misreading the job market
- The BoC is caught in a trap of serially underestimating fiscal stimulus
- Why Canadian retaliation risk is higher than markets seem to be assuming
- Macklem to speak on mandate review next week

The BoC delivered another –50bps mega-cut and borrowing costs moved higher. Huh? Allow me to explain why and why I generally welcome the outcome that conforms to earlier stated wishes where I hoped their bias would be more neutral if they upsized again.

THE BIAS CARRIED THE DAY FOR MARKETS

The Bank of Canada met almost everyone's expectations including ours and cut 50bps today. The statement is [here](#) and the opening remarks to the press conference are [here](#). I wasn't a fan of them doing so despite forecasting the outcome but like the more careful bias which is what drove the market impact. This was, in short, one of the most hawkish upsized cuts in the history of upsized rate cuts across global central banks. It almost had the feel of having an apology note attached to the decision.

That's because the market outcomes left traders with a lump of coal in their stockings care of the BoC. Dovish market bets on the Bank of Canada got crushed despite delivering the 50bps cut that itself was largely priced going in (charts 1–2). The Canada 2s yield soared by 9bps post-statement to 2.93%, Canada's 5-year yield moved up by a similar amount which pressures mortgage funding a touch. The whole Canadian curve is underperforming US Treasuries somewhat. The Canadian dollar appreciated by about half a cent to the USD and is among the strongest currencies on the day. The TSX reacted negatively at first, but then shook it all off.

The reason for this rates market reaction is because the BoC called time out on forward guidance. They signalled greater uncertainty over future rate cuts than in the prior statement.

Here's how. The final paragraph now says this:

"Governing Council 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."

Compare that to the final paragraph in the prior statement back in October:

"If the economy evolves broadly in line with our latest forecast, we expect to reduce the policy rate further. However, the timing and pace of further reductions in the policy rate will be guided by incoming information and our assessment of its implications for the inflation outlook. We will take decisions one meeting at a time."

That's a much less definitive bias by no longer explicitly referencing future rate reductions. They're not ruling them out. But they are no longer committing themselves to this path.

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Except that, in classic BoC fashion, the press conference kind of garbled the message. The statement lacked commitment to further easing, but Macklem's comments reintroduced this commitment.

That doesn't lend confidence they have a clue what their next steps may be and I wouldn't blame them for that given the uncertainties into 2025.

NOT DONE CUTTING

Given the statement's changed concluding paragraph on the bias that signalled more of a gradual approach, it was natural to expect questions during the presser on what this signalled going forward. Macklem was asked point blank whether he expects to cut rates further and said this:

"Going forward, I expect Governing Council will be considering further reductions in the policy rate, but with the policy rate now a lot lower, I anticipate we'll be taking a more gradual approach. That means more gradual than 50bps at the last two meetings. That's a pretty wide zone. That's deliberate. We'll take our decisions one at a time.

When asked whether Canadians should be prepared for a pause, Macklem more explicitly stated that further reductions are expected:

"We've lowered interest rates substantially at the last two meetings. We expect we will be considering further reductions, but we'll be taking a more gradual approach. One at a time."

DID MACKLEM SIGNAL THE BOC IS AT NEUTRAL?

I'm not sure, but Macklem may be signalling that the BoC believes it is at the neutral policy rate.

The opening remarks and during the presser's Q&A emphasized that "monetary policy no longer needs to be clearly in restrictive territory." Emphasis must be placed upon 'clearly' as the chosen word.

Ergo, it might be still be restrictive, but he's not really sure. Why that's the case could be because the very highest estimate of neutral at the BoC is 3.25% which is where we are now, but 2.25%–3.25% with a 2.75% mid-point is the range they have settled upon ([here](#)). The next update for this measure is due probably by April 2025 and has to incorporate major changes to immigration and potential growth etc.

WHY 25BPS OVER 50BPS?

When asked why they cut 50bps instead of 25bps and whether another mega cut is providing a negative signalling effect that the BoC thinks the Canadian economy is on the brink of recession, Macklem said this:

"We discussed both 25 and 50bps options. The data since the last decision has been somewhat mixed. There have been some negatives and some positives. GDP was weaker than expected, but consumption and housing picked up. You're starting to see lower interest rates pass through. The labour market continues to soften [ed. wrong....] and there were stronger GDP revisions. There are mixed signals. We did coalesce around a 50bps cut really for two reasons. Council agreed we no longer needed policy clearly in restrictive territory. Tighter monetary policy worked to bring inflation down. The second element is that the data tilts toward a softer outlook for GDP growth than we published in October. Q3 was weaker and it looks like Q4 is going to be weaker and lower immigration targets will lower GDP growth next year [ed. but also lower potential GDP...]."

WHAT'S MISSING

There was an interesting absence of any statement-codified reference to per capita arguments this time. The prior statement emphasized consumption "declining on a per person basis." This one struck that out. It should have never been statement codified in the first place.

Why? Because it is at an inflection point. Consumption is solid. Over the forecast horizon we're likely to get decent consumption and waning population growth which turns the per capita argument around. Macklem said in the presser that he expects per capita GDP and consumption to rise in 2025. So do we.

THE BOC IS SERIALLY MISREADING THE JOB MARKET

There were a few questions on the job market in the presser. It's my belief that the BoC is fundamentally misreading labour market conditions to date.

When asked about the rise in the unemployment rate versus employment gains, Macklem said this:

“You can't just look at the employment rate. You can't just look at the UR. You need to look at the full range of indicators. The concentration of unemployment is concentrated upon young people and newcomers. We haven't seen widespread layoffs. But when you look at the unemployment rate overall there is clearly some slack in the labour market. Going forward we want to see growth and hiring pick up.”

The implication to these comments is that the BoC thinks that addressing the rise in the UR—that has been overwhelmingly driven by too many international students and temporary foreign workers being admitted to the country (chart 3)—is his to fix. I fundamentally disagree as written several times. Cut, cut, cut to give marginally attached folks more jobs while overheating everything else? The fix to immigration policy is on the way and if successful then the UR is likely to move down as the number of temps in the country dries up. Governor Macklem is mistaken to be doing the immigration minister's job in my view.

TARIFF RISKS FIGURED PROMINENTLY

Questions on tariffs dominated the press conference after the BoC statement-codified reference to the risk by stating:

“In addition, the possibility the incoming US administration will impose new tariffs on Canadian exports to the United States has increased uncertainty and clouded the economic outlook.”

When asked in the presser how much of a role did the threat of tariffs play in the half point cut in terms of taking out insurance, Macklem had this to say:

“We did underline that the threat of new tariffs is a major new source of uncertainty. But the reality is we don't know if those tariffs will be implemented, we don't know what exemptions there may be, we don't know if Canada will retaliate. All those things are very important to what could happen to the Canadian economy. Even the uncertainty will hold back investment decisions [ed. reducing actual and potential growth] and so it is probably already having some effect. But the decision we took today reflected what we see in the data today. There's no question that if tariffs at this level did go through then they would be very disruptive to the Canadian and US economies.

When also asked whether tariffs return Canada to the scenario of a recession or hard landing in 2025, Macklem said:

“As I said in the opening statement, I expect GDP growth will be lower than our prior forecast, but you can see in the more recent indicators that consumer spending is picking up. Since then, we've reduced interest rates by another 100bps. We do think population growth will come down and pull GDP down [ed. again, both actual and potential GDP!] but at the same time we expect per capita GDP and per capita consumption to be recovering. We're not expecting a recession.”

That's not the same as saying tariffs don't pose risk of a severe recession, but they do.

Macklem also pointed to Box 2 in the July 2019 MPR ([here](#)) that modelled the impact of 25% global tariffs and said they are updating this analysis, intimating the results will be presented in the January MPR presumably conditioned upon whether tariffs are implemented.

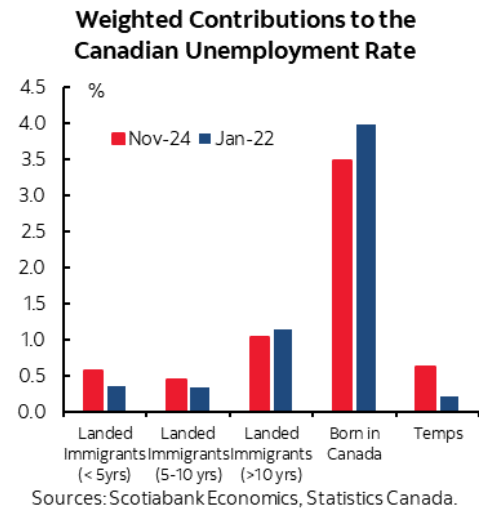
In French, Macklem offered further elaboration:

“We cannot adjust monetary policy based on something that might happen. But if it does happen, we anticipate there will be major implications for the Canadian economy but this is something we will have to consider. The impact on the Canadian economy will be determined by how high tariffs will go, what kind, exceptions, retaliation. The effects will depend on exactly what happens.”

MISREADING FISCAL STIMULUS PLANS

I think they're misreading the fiscal stimulus issue by stating they “will look through effects that are temporary and focus on underlying trends to guide its policy decisions.” The underlying trend, Governor, is toward serial application of more and more fiscal stimulus each and every year as the BoC's take on this lags in serial fashion, and we should expect even more into 2025. The BoC is taking the federal government at its word that GST/HST cuts will expire in February. We're not. I think the cut will be extended if not made permanent. A price spike 3 months closer to an election? Four actually by the time we get the data. That's unlikely. So is the assumption that no further fiscal stimulus lies ahead given current polling, while handouts galore are going to make it very difficult to look through the consequences for consumer spending and housing demand into Spring.

Chart 3



THE BOC CHERRY-PICKED THE GDP DATA

Usually when GDP is soft but final domestic demand is solid, they point that out. They chose not to this time. Q3 GDP was dragged down heavily by reduced investment in inventories. There should have been more emphasis upon strong consumption and final domestic demand.

MACKLEM BASICALLY REBUKED FORMER GOVERNOR POLOZ

When asked in the presser about former BoC Governor Poloz's comments about how he thinks Canada is in recession, Macklem had this to say:

"The traditional definition of a recession is at least two declines in GDP in a row. The economy is not growing rapidly but is not contracting. On a per capita basis we have seen negative quarters which indicates we are in excess supply, the economy is soft. The UR has gone up, but we have not seen widespread job losses as you would typically see in a recession. We needed weak growth to take the steam out of the economy to cool inflation but we have not seen widespread job losses as you would see in a recession."

MACKLEM DISMISSED CAD WEAKNESS

When asked in the presser how much of a risk is a weak CAD to inflation, Macklem said this:

"We don't forecast CAD and we don't target CAD. A flexible exchange rate is needed. What is driving depreciation? Most of it is an appreciated in the USD that has been strong against pretty much every other currency. CAD against other crosses has been very little changed. A weaker CAD is one of the channels through which monetary policy works."

MACKLEM'S SPEECH NEXT WEEK WILL BE ON MANDATE REVIEW

During the presser, Macklem and Rogers were asked to elaborate upon recent comments regarding what the BoC is considering as its mandate review under the Inflation Renewal Agreement comes up for renewal in 2026. Macklem said stay tuned:

"I'll have more to say about this next Monday in my year-end speech as we launch the review next year to be ready for 2026."

WILL CANADA RETALIATE? AND IF SO, HOW?

I think markets are underestimating the implied probability that Canada will retaliate in a meaningful way if the US goes ahead with Trump's tariffs threats. This is seen in ongoing pricing of rate cuts by the Bank of Canada next year toward around 2½%.

Before getting to why, none of this is the stuff of our base case at this point. First, we don't know for sure there will be tariffs. Trump demanded NAFTA be torn up in NAFTA 2.0 and all sorts of changes, only to go out like a lamb as there were token changes at least in Canada's case. Trump doesn't have much credibility to draw upon when it comes to the opening bid, which reduces the alleged usefulness of 'art of the deal' approach in a repeated game.

We also don't know how broadly they'll be applied. Energy you say? 82% of vehicle sales are trucks in the US and tariffs would hit them hard. And autos? The integrated cross border operations would slam the US as hard as Canada.

We don't know how long they'll last. If temporary, like a month, then the BoC would look largely through them. If longer lived then that's hard to do, but then it becomes an issue of whether Canada retaliates and if so how meaningfully it does so.

On that, this isn't 2018-19 imo. And I mean my opinion only for the sake of discussing meaningful risks. Back then the US tariffs were targeted toward steel and aluminum. Canada triggered its right to retaliate in kind by hitting Kentucky bourbon, ketchup and a list of other things, while aiming them at politically sensitive areas.

But token retaliation this time? In response to major tariffs? I'm not so sure that's a reasonable assumption.

Canada would worsen the impact if it retaliated in a meaningful way. That's certainly so if 25% across the board is met with the same the other way. There is no doubt about the harsh impact. There would be a worse GDP hit, higher prices, less easing if not tightening, wider fiscal deficits, more bond issuance, etc etc. Fun, not.

Alternatively, think of a game theory approach. Canada needs to think beyond one quarter's GDP and ask how it wants to spend the next four years. Do you want your lunch stolen each day for the next four years? Or, at greater short-term cost, do you wish to make it clear that there will be a high cost to the US every time it tries to hit Canada hard. Force met by force, in the language that Trump speaks.

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I think that's the risk in terms of how politics may evolve in Canada. And I wouldn't rule it out. It could be a very tense time until both sides come to their senses.

Not only is the nature of the tariff threat fundamentally different this time; so are the Canadian politics and the incoming US administration would be wise not to ignore this point.

Back in 2018 the Trudeau administration was still riding pretty high off of the majority sweep in 2015. Now it's not, to say the least. An election year lurks ahead. I personally think PM Trudeau was the adult in the room at the Florida dinner with Trump and engaged the incoming administration for which he gets high marks in my books. Except for the fact that rational engagement doesn't work with this US administration. But to the public, and in the aftermath of Trump's taunting, Trudeau appears weak. That's certainly how his constant critics are painting him such that they'll deserve some of the blame if severe retaliation comes to fruition. That's not a good image into an election year.

I think a significant risk is that the US administration may find that it gets a stern rebuke from the Canadian government on tariffs with severe consequences across the large number of US states that name Canada as their number one trading partner. The effects could arrive just in time for the 2026 mid-terms and wouldn't align well with the views of US voters who think the incoming administration will do a better job of running the economy.

Please also see the attached statement comparison.

RELEASE DATE: December 11, 2024

The Bank of Canada today reduced its target for the overnight rate to 3¼%, with the Bank Rate at 3¾% and the deposit rate at 3¼%. The Bank is continuing its policy of balance sheet normalization.

The global economy is evolving largely as expected in the Bank's October Monetary Policy Report (MPR). In the United States, the economy continues to show broad-based strength, with robust consumption and a solid labour market. US inflation has been holding steady, with some price pressures persisting. In the euro area, recent indicators point to weaker growth. In China, recent policy actions combined with strong exports are supporting growth, but household spending remains subdued. Global financial conditions have eased and the Canadian dollar has depreciated in the face of broad-based strength in the US dollar.

In Canada, the economy grew by 1% in the third quarter, somewhat below the Bank's October projection, and the fourth quarter also looks weaker than projected. Third-quarter GDP growth was pulled down by business investment, inventories and exports. In contrast, consumer spending and housing activity both picked up, ***suggesting lower interest rates are beginning to boost household spending. Historical revisions to the National Accounts have increased the level of GDP over the past three years, largely reflecting higher investment and consumption. The unemployment rate rose to 6.8% in November as employment continued to grow more slowly than the labour force. Wage growth showed some signs of easing, but remains elevated relative to productivity.***

A number of policy measures have been announced that will affect the outlook for near-term growth and inflation in Canada. ***Reductions in targeted immigration levels suggest GDP growth next year will be below the Bank's October forecast. The effects on inflation will likely be more muted, given that lower immigration dampens both demand and supply. Other federal and provincial policies—including a temporary suspension of the GST on some consumer products, one-time payments to individuals, and changes to mortgage rules—will affect the dynamics of demand and inflation. The Bank will look through effects that are temporary and focus on underlying trends to guide its policy decisions.***

In addition, the possibility the incoming US administration will impose new tariffs on Canadian exports to the United States has increased uncertainty and clouded the economic outlook.

CPI inflation has been about 2% since the summer, and is expected to average close to the 2% target over the next couple of years. Since October, the upward pressure on inflation from shelter and the downward pressure from goods prices have both moderated as expected. Looking ahead, the GST holiday will temporarily lower inflation but that will be unwound once the GST break ends. Measures of core inflation will help us assess the trend in CPI inflation.

With inflation around 2%, the economy in excess supply, and recent indicators tilted towards softer growth than projected, Governing Council decided to reduce the policy rate by a further 50 basis points to support growth and keep inflation close to the middle of the 1-3% target range. ***Governing Council 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. The Bank is committed to maintaining price stability for Canadians by keeping inflation close to the 2% target.

RELEASE DATE: October 23, 2024

The Bank of Canada today reduced its target for the overnight rate to 3¼%, with the Bank Rate at 4% and the deposit rate at 3¼%. The Bank is continuing its policy of balance sheet normalization.

The Bank continues to expect the global economy to expand at a rate of about 3% over the next two years. Growth in the United States is now expected to be stronger than previously forecast while the outlook for China remains subdued. Growth in the euro area has been soft but should recover modestly next year. Inflation in advanced economies has declined in recent months, and is now around central bank targets. Global financial conditions have eased since July, in part because of market expectations of lower policy interest rates. Global oil prices are about \$10 lower than assumed in the July Monetary Policy Report (MPR).

In Canada, the economy grew at around 2% in the first half of the year and we expect growth of 1¾% in the second half. Consumption has continued to grow but is declining on a per person basis. Exports have been boosted by the opening of the Trans Mountain Expansion pipeline. The labour market remains soft—the unemployment rate was at 6.5% in September. Population growth has continued to expand the labour force while hiring has been modest. This has particularly affected young people and newcomers to Canada. Wage growth remains elevated relative to productivity growth. Overall, the economy continues to be in excess supply.

GDP growth is forecast to strengthen gradually over the projection horizon, supported by lower interest rates. This forecast largely reflects the net effect of a gradual pick up in consumer spending per person and slower population growth. Residential investment growth is also projected to rise as strong demand for housing lifts sales and spending on renovations. Business investment is expected to strengthen as demand picks up, and exports should remain strong, supported by robust demand from the United States.

Overall, the Bank forecasts GDP growth of 1.2% in 2024, 2.1% in 2025, and 2.3% in 2026. As the economy strengthens, excess supply is gradually absorbed.

CPI inflation has declined significantly from 2.7% in June to 1.6% in September. Inflation in shelter costs remains elevated but has begun to ease. Excess supply elsewhere in the economy has reduced inflation in the prices of many goods and services. The drop in global oil prices has led to lower gasoline prices. These factors have all combined to bring inflation down. The Bank's preferred measures of core inflation are now below 2½%. With inflationary pressures no longer broad-based, business and consumer inflation expectations have largely normalized.

The Bank expects inflation to remain close to the target over the projection horizon, with the upward and downward pressures on inflation roughly balancing out. The upward pressure from shelter and other services gradually diminishes, and the downward pressure on inflation recedes as excess supply in the economy is absorbed.

With inflation now back around the 2% target, Governing Council decided to reduce the policy rate by 50 basis points to support economic growth and keep inflation close to the middle of the 1% to 3% range. ***If the economy evolves broadly in line with our latest forecast, we expect to reduce the policy rate further. However, the timing and pace of further reductions in the policy rate will be guided by incoming information and our assessment of its implications for the inflation outlook. We will take decisions one meeting at a time.*** The Bank is committed to maintaining price stability for Canadians by keeping inflation close to the 2% target.

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