Scotiabank

GLOBAL ECONOMICS

SCOTIA FLASH

June 4, 2025

Bank of Canada Holds Fire—Contradicts on Guidance

- **BoC remained on hold at a 2.75% policy rate as forecast all year**
- **Canadian markets only cared about US data while ignoring the BoC…**
- **…and the way markets interpreted US ISM is contestable**
- **The BoC is trying to have its cake and eat it too on forward guidance**
- **The BoC remains unsure about returning to the forecast game**

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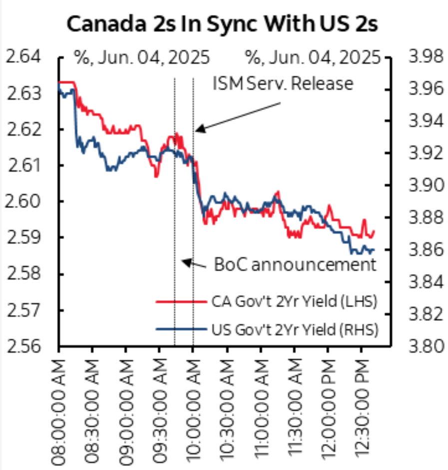
The Bank of Canada held its policy rate unchanged at 2.75% as forecast by Scotia Economics for this meeting all year long. Guidance was reserved and careful again which leaves us in the same boat as previously while time brings out more data and developments to hopefully add future clarity to policy risks.

Having said that, I found that despite explicitly stating they are not offering forward guidance, the form of forward guidance they did offer seemed odd. I'll come back to this point below.

The policy statement is **here** and Governor Macklem's opening remarks to his press conference are **here**. Please also see the appendix for a statement comparison and the transcript of his press conference.

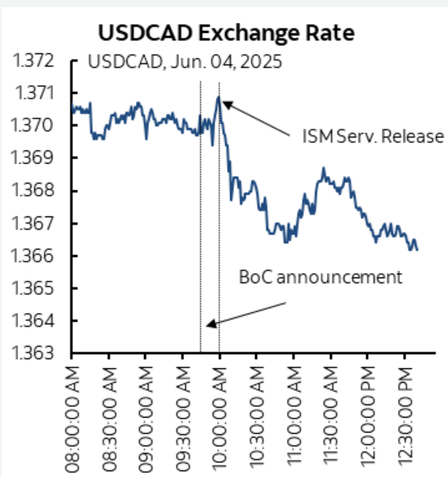
Nevertheless, US data mattered more than the Bank of Canada even to Canadian markets. Canada 2s rallied exactly in sync with US 2s from the time when the weak US ADP private payrolls report landed and through the weaker ISM-services headline number (chart 1). Movement in USDCAD was entirely driven by the US data that drove a weaker USD against all major crosses and CAD kind of hitched along for the ride (chart 2). Still, I think markets misinterpreted ISM by ignoring how mixed signals on activity readings (weaker growth but slightly firmer employment) trade off against higher price signals including some aggressive comments by respondents on tariff risks to prices. US ISM price gauges point to a looming surge in US inflation (chart 3).

Chart 1



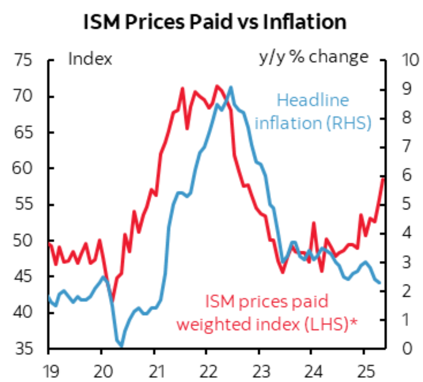
Sources: Scotiabank Economics, Bloomberg.

Chart 2



Sources: Scotiabank Economics, Bloomberg.

Chart 3



*Weighted at 75% of ISM-services prices paid index and 10% of ISM-mfg. prices paid index.
Sources: Scotiabank Economics, BLS, ISM.

THE NOT-FORWARD-GUIDANCE FORWARD GUIDANCE

I found the BoC's communications around forward guidance to be confusing. On the one hand they say they're not offering any given the uncertainty and don't even have the confidence to forecast.

On the other, they have the confidence to significantly intimate that the July decision may be live and boils down to the pair of inflation reports between now and the next decision on July 30th.

The first supporting observation is that in response to being asked whether inflation needs to slow in both May and June to consider a rate cut on July 30th, Macklem emphasized that "yes we will be looking at those carefully." If he wasn't open to a July cut he could've either been explicit or merely said it depends on a lot more than that and dismissed the question as a bit of a ruse. Not having done so could be construed as either form of guidance when taken alongside the next point, or a slip.

He also said in his opening remarks that "Governing Council thought that there could be a need for a further reduction in the policy rate if the economy weakens and if price pressures are contained" but in fairness noted that "I wouldn't interpret that as forward guidance, it was just a part of our deliberations."

Those are big 'ifs'. And yet pairing close monitoring of the next two inflation reports while mentioning only one scenario that would happen to favour easing would be taken by anyone with the remotest of skill in terms of interpreting central bank speak as leaving the door open to easing by that meeting. He should also be asked whether two months of weak activity readings would also be enough to tip the balance.

But wait a minute. If you don't have confidence to forecast anything, why are you even hinting at this outcome? He could just as easily have said nothing especially since this isn't exactly his first rodeo. You're either not providing any forward guidance or you are, you can't have it both ways.

Does this mean that should underlying inflation in May come off the surge in April's readings and June averages out the pair of readings to be less disconcerting than the recent profile while the effects on short-term activity indicators deteriorates then they could cut at that meeting? Or are we to emphasize the attention placed on all of the uncertainty surrounding the rest of the views they communicated?

I lean to the latter but am not certain. What I'm confident in saying is that it's a stretch to say that by July 30th we will have enough confidence to possibly entertain easing given the long lagging effects of complex influences on job #1 which is containing future inflation risk.

And why not emphasize alternate scenarios? Why pick one?? Why not also say something like "If activity readings showcase some resilience and price pressures surge then we will be very patient." Or some other more hawkish or more dovish remark. But no, Macklem went needlessly out of his way to emphasize near-term data dependence and paired it with one and only one scenario. Something doesn't squarely line up in the overall suite of communications here.

I think Macklem should come back and clarify what he meant by this. Failing that, maybe DepGov Kozicki's talk on communications will, errr, clean up some of their communications today and also communicate when they expect to return to forecasting like markets and the street continue to do. Dismissing the optics around these inconsistencies would only add monetary policy instability to uncertain times.

STATEMENT CHANGES

Well, so much for a shorter, non-MPR statement. See the appendix for a loose statement comparison.

Key is what did not change which is this paragraph that just about sums up the conundrum facing the BoC:

"Governing Council is proceeding carefully, with particular attention to the risks and uncertainties facing the Canadian economy. These include: the extent to which higher US tariffs reduce demand for Canadian exports; how much this spills over into business investment, employment and household spending; how much and how quickly cost increases are passed on to consumer prices; and how inflation expectations evolve."

The broad challenge to formulating inflation views at the BoC continues to involve trading off "the timing and strength of both the downward pressures on inflation from a weaker economy and the upward pressures on inflation from higher costs."

They flagged "highly uncertain" outcomes of trade negotiations and that "new trade actions are still being threatened. Uncertainty remains high." They pre-written statement doesn't appear to reflect the doubling of US metals tariffs to 50%.

On Canadian GDP growth, they flagged that is was "slightly stronger than the Bank had forecast, while the composition of GDP growth was largely as expected."

The BoC put emphasis upon pulled-forward growth, stating that "The economy is expected to be considerably weaker in the second quarter" including "subdued" final domestic demand that is freer of inventory and trade distortions.

On inflation, the BoC acknowledged that CPI inflation excluding tax effects was "slightly stronger than the Bank had expected" and that there was "unexpected firmness in recent inflation data" while its preferred core measures "moved up." They continue to cite surveys emphasizing tariff pass through risks into prices.

PRESS CONFERENCE TRANSCRIPTS

Here is an attempt at a full press conference transcript in lieu of one being provided by the BoC and with the usual caveat that any omissions or errors are to be blamed on my typing abilities.

Q1. Does inflation need to slow in both May and June before you consider a rate cut on July 30th?

A1. We will get two more CPI reports before our next decision and yes we will be looking at those carefully. We did see CPI ex-tax move up in April. Our preferred measures of core and the distribution of price changes all moved up in April. That has got our attention. There is some underlying volatility in components so you don't want to over-rotate on one month's data. But the fact that quite a few measures moved up does makes us think underlying inflation remains firmer than we thought. We'll have to factor all that in in July.

Q2. What does 'contained' mean in terms of inflation? Contained at current levels or to come off a bit?

A2. There is a lot of uncertainty. We are less forward looking. The big message here is the Canadian economy is showing some resilience to tariffs. Consumption was softer in Q1, you can see the impact on tariffs, but despite a really big drop in confidence, consumer spending continued to grow and so did business investment. Having said that, the longer these tariffs and uncertainty go on, the more it is going to weigh on the economy and the more it is likely to weigh on inflation, but we are also seeing higher costs from trade disruptions and we will start to see higher prices from retaliatory tariffs in the months ahead. Governing Council thought that there could be a need for a further reduction in the policy rate if the economy weakens and if price pressures are contained. I wouldn't interpret that as forward guidance, it was just a part of our deliberations.

Q3. Would the BoC be willing to look through any further rally in CAD or view it as disinflationary?

A3. Rogers speaking. We don't have a target for CAD. There is no single metric we are looking at. CAD has strengthened of late, we do think that has weighed on inflation, but we have to look at other drivers. [ed . I find it untenable that a BoC official would expect such quick pass through of CAD strength into inflation].

Q4. Where do you see the path now relative to the two scenarios you presented in the April MPR?

A4. Macklem speaking again. Referencing higher metals tariffs. Pointing to Trump moving back and forth on tariffs. It's still a moving target. There is a reason why the first line of the statement was that uncertainty is still high. Since April, the likelihood of Scenario 2 which is a severe protracted trade war does appear to have come down. China and the US have stepped back from extremely high tariffs. The US is negotiating with a number of countries including Canada and has the potential to roll back tariffs. But at this point, the outcome is highly uncertain. I hope the situation becomes clearer and that we can go back to a central scenario but that depends on how things play out.

Q5. How has the lack of a Spring budget affected your forecasting?

A5. We're doing what we normally do. We take on board what changes after we have the decisions. [ed. I never buy that. That's a public line. Behind the scenes is different, and if it isn't, then how can the BoC justify not formulating expectations around potential future fiscal policy steps while incorporating known ways and means motions to date just like markets and the street have to?].

Q6. How much did the April inflation report impact your decision?

A6. That's a hard question to answer. It's still too soon to see the impact of retaliatory tariffs. We will be able to see tariff versus non-tariff effects in the coming months but it's too early to see now. That doesn't mean that the trade disruption isn't having any impact on prices. We're seeing supply chain changes that have costs. Because that's spread out through many goods it's hard to pinpoint at this point. The other thing about the exchange rate is that earlier depreciation may be coming through some prices because it takes some time to pass through [ed. contradicting Rogers sort of while quoting CAD as a retail guy]. As I said we'll get two more CPI reports between now and the July decision and we'll be parsing through the effects. [ed. That seems odd to me. The implication is that the July decision depends on just two CPI reports?? There are long lags around a lot of what is going on here.]

Q7. Doesn't uncertainty alone tilt things in favour of a rate cut?

A7. Yes uncertainty will tend to weaken activity and yes we are seeing that in the Canadian economy. There is diversity of opinion. If tariffs continue to weaken the economy and cost pressures on inflation are contained then there could be a need for a further reduction in the policy rate. [ed. again, big 'ifs']

Q8. How unprecedented is this for you and the Bank?

A8. I'm more worried about it being difficult for businesses and households.

Q9. There is no reference to "acting decisively" in this statement. Does that suggest the risks have diminished?

A9. I wouldn't over-rotate on what was there last time and what is not this time. Repeated earlier comments

Q10. General question on rotation of trade exposures, stickiness of exposure to US etc and how it impacts the BoC.

A10. Rambling answer on the need to develop internal markets and diversify trade

Q11. Do you expect to deliver forecasts at the July decision?

A11. Rogers speaking. It is our hope. We are at the mercy of trade policy developments in the US.

Q12. Can you say more about the deliberations at this meeting?

A12. Macklem speaking. I think you're going to have to wait for the Summary of Deliberations. There is some difference of views on the most likely paths ahead. But as I said, on balance, there was agreement across Governing Council that if the tariffs and uncertainty continued and there is further weakness and those cost pressures on inflation are contained then there could be a need for a further reduction in our policy rate. Don't take that as forward guidance. It is merely a product of our deliberations. We are proceeding carefully and being less forward looking than usual.

Q13. Do you consider market confidence (stocks etc) as a forward gauge?

A13. We need to keep focused on uncertainty and volatility. We didn't see market dysfunction in April. We are not out of the woods yet on volatility and uncertainty.

Q14. Macklem concluded the press conference by offering answers to two questions he said were not asked. Either that, or maybe he’s superstitious and you can’t have 13 questions on a list. One is the impact of the forest fires across much of Canada. He generally offered supporting words to the fire fighters and affected individuals and businesses while saying they are having an economic impact but it's too early to assess. I would add that this isn’t necessarily anything that monetary policy can address.

But I fully, completely concur with his concluding “Go Oilers” remark. I hope they whoop those tax-advantaged, no income-tax, subsidized, tariff-throwing Florida Panthers!!

RELEASE DATE: June 4, 2025

The Bank of Canada today maintained its target for the overnight rate at 2.75%, with the Bank Rate at 3% and the deposit rate at 2.70%.

Since the April *Monetary Policy Report*, the US administration has continued to increase and decrease various tariffs. China and the United States have stepped back from extremely high tariffs and bilateral trade negotiations have begun with a number of countries. However, the outcomes of these negotiations are highly uncertain, tariff rates are well above their levels at the beginning of 2025, and new trade actions are still being threatened. Uncertainty remains high.

While the global economy has shown resilience in recent months, this partly reflects a temporary surge in activity to get ahead of tariffs. In the United States, domestic demand remained relatively strong but higher imports pulled down first-quarter GDP. US inflation has ticked down but remains above 2%, with the price effects of tariffs still to come. In Europe, economic growth has been supported by exports, while defence spending is set to increase. China's economy has slowed as the effects of past fiscal support fade. More recently, high tariffs have begun to curtail Chinese exports to the US. Since the financial market turmoil in April, risk assets have largely recovered and volatility has diminished, although markets remain sensitive to US policy announcements. Oil prices have fluctuated but remain close to their levels at the time of the April MPR.

In Canada, economic growth in the first quarter came in at 2.2%, slightly stronger than the Bank had forecast, while the composition of GDP growth was largely as expected. The pull-forward of exports to the United States and inventory accumulation boosted activity, with final domestic demand roughly flat. Strong spending on machinery and equipment held up growth in business investment by more than expected. Consumption slowed from its very strong fourth-quarter pace, but continued to grow despite a large drop in consumer confidence. Housing activity was down, driven by a sharp contraction in resales. Government spending also declined. The labour market has weakened, particularly in trade-intensive sectors, and unemployment has risen to 6.9%. The economy is expected to be considerably weaker in the second quarter, with the strength in exports and inventories reversing and final domestic demand remaining subdued.

CPI inflation eased to 1.7% in April, as the elimination of the federal consumer carbon tax reduced inflation by 0.6 percentage points. ***Excluding taxes, inflation rose 2.3% in April, slightly stronger than the Bank had expected. The Bank's preferred measures of core inflation, as well as other measures of underlying inflation, moved up. Recent surveys indicate that households continue to expect that tariffs will raise prices and many businesses say they intend to pass on the costs of higher tariffs. The Bank will be watching all these indicators closely to gauge how inflationary pressures are evolving.***

With uncertainty about US tariffs still high, the Canadian economy softer but not sharply weaker, and some unexpected firmness in recent inflation data, Governing Council decided to hold the policy rate as we gain more information on US trade policy and its impacts. We will continue to assess the timing and strength of both the downward pressures on inflation from a weaker economy and the upward pressures on inflation from higher costs.

Governing Council is proceeding carefully, with particular attention to the risks and uncertainties facing the Canadian economy. These include: the extent to which higher US tariffs reduce demand for Canadian exports; how much this spills over into business investment, employment and household spending; how much and how quickly cost increases are passed on to consumer prices; and how inflation expectations evolve.

We are focused on ensuring that Canadians continue to have confidence in price stability through this period of global upheaval. We will support economic growth while ensuring inflation remains well controlled.

RELEASE DATE: April 16, 2025

The Bank of Canada today maintained its target for the overnight rate at 2.75%, with the Bank Rate at 3% and the deposit rate at 2.70%.

The major shift in direction of US trade policy and the unpredictability of tariffs have increased uncertainty, diminished prospects for economic growth, and raised inflation expectations. Pervasive uncertainty makes it unusually challenging to project GDP growth and inflation in Canada and globally. Instead, the April *Monetary Policy Report* (MPR) presents two scenarios that explore different paths for US trade policy. In the first scenario, uncertainty is high but tariffs are limited in scope. Canadian growth weakens temporarily and inflation remains around the 2% target. In the second scenario, a protracted trade war causes Canada's economy to fall into recession this year and inflation rises temporarily above 3% next year. Many other trade policy scenarios are possible. There is also an unusual degree of uncertainty about the economic outcomes within any scenario, since the magnitude and speed of the shift in US trade policy are unprecedented.

Global economic growth was solid in late 2024 and inflation has been easing towards central bank targets. However, tariffs and uncertainty have weakened the outlook. In the United States, the economy is showing signs of slowing amid rising policy uncertainty and rapidly deteriorating sentiment, while inflation expectations have risen. In the euro area, growth has been modest in early 2025, with continued weakness in the manufacturing sector. China's economy was strong at the end of 2024 but more recent data shows it slowing modestly.

Financial markets have been roiled by serial tariff announcements, postponements and continued threats of escalation. This extreme market volatility is adding to uncertainty. Oil prices have declined substantially since January, mainly reflecting weaker prospects for global growth. Canada's exchange rate has recently appreciated as a result of broad US dollar weakness.

In Canada, the economy is slowing as tariff announcements and uncertainty pull down consumer and business confidence. Consumption, residential investment and business spending all look to have weakened in the first quarter. Trade tensions are also disrupting recovery in the labour market. Employment declined in March and businesses are reporting plans to slow their hiring. Wage growth continues to show signs of moderation.

Inflation was 2.3% in March, lower than in February but still higher than 1.8% at the time of the January MPR. The higher inflation in the last couple of months reflects some rebound in goods price inflation and the end of the temporary suspension of the GST/HST. Starting in April, CPI inflation will be pulled down for one year by the removal of the consumer carbon tax. Lower global oil prices will also dampen inflation in the near term. However, we expect tariffs and supply chain disruptions to push up some prices. How much upward pressure this puts on inflation will depend on the evolution of tariffs and how quickly businesses pass on higher costs to consumers. Short-term inflation expectations have moved up, as businesses and consumers anticipate higher costs from trade conflict and supply disruptions. Longer term inflation expectations are little changed.

Governing Council will continue to assess the timing and strength of both the downward pressures on inflation from a weaker economy and the upward pressures on inflation from higher costs. Our focus will be on ensuring that Canadians continue to have confidence in price stability through this period of global upheaval. This means we will support economic growth while ensuring that inflation remains well controlled.

Governing Council will proceed carefully, with particular attention to the risks and uncertainties facing the Canadian economy. These include: the extent to which higher tariffs reduce demand for Canadian exports; how much this spills over into business investment, employment and household spending; how much and how quickly cost increases are passed on to consumer prices; and how inflation expectations evolve.

Monetary policy cannot resolve trade uncertainty or offset the impacts of a trade war. What it can and must do is maintain price stability for Canadians.