

Contributors

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Chart 1

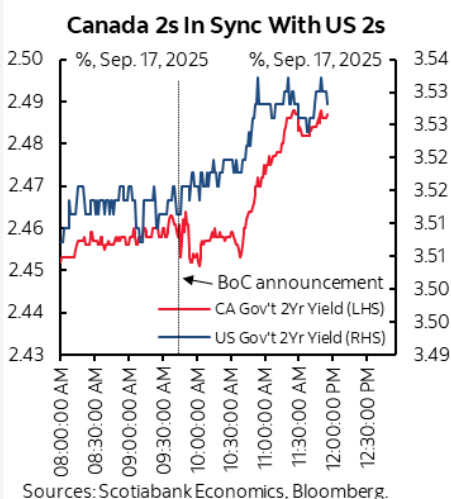
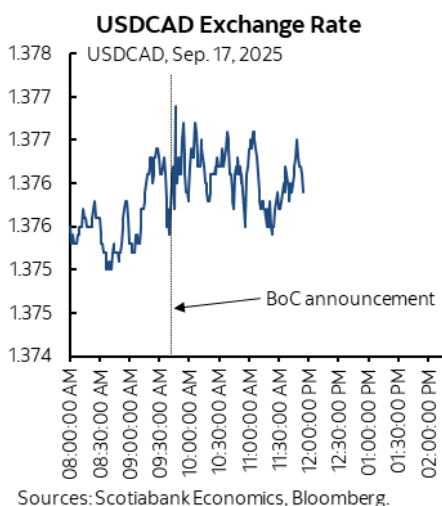


Chart 2



BoC's Open Bias Sets a High Bar Against Back-to-Back

- The BoC cut its policy rate by 25bps as most had expected
- The bias was cagey and noncommittal as expected
- There are multiple reasons why going back-to-back may not happen
- The BoC signalled no great concern over CORRA and funding markets at this time
- Statement comparison and press conference transcript are provided

The Bank of Canada cut its overnight rate by 25bps as widely expected by all but one Canadian dealer and basically fully priced going in. There was a mildly hawkish response in market rates (chart 1) perhaps due to the issues surrounding the bias that I'll explain, but it was also correlated with simultaneous movement in US yields which is why USDCAD simply danced sideways (chart 2) ahead of the FOMC.

Key, however, is a significant question mark around the forward bias—if any. It may signal that there is a high bar to following up with another cut at the October 29th decision versus perhaps a cut-pause framework as advised going in. The odds of being done after just one cut are pretty low in my view given the overall tone of the rest of the statement and the general pointlessness to grabbing a single chip out of the bag.

The overall bias, however, was careful, cagey, noncommittal, and spoken in riddles—and hence very much in keeping with Macklem's style that rarely holds the market's hand. Our forecast remains for one more 25bps cut in Q4 but exactly when will be informed by data and developments.

A KEY STATEMENT OMISSION

A key omission from the statement may have contained information that was immediately flagged in my internal chat rooms. It could be much ado about nothing and needs to be combined with other points below.

The issue is that the last statement said:

"If a weakening economy puts further downward pressure on inflation and the upward price pressures from the trade disruptions are contained, there may be a need for a reduction in the policy interest rate."

Since it's such a short statement—at least compared to the prior one—why not just repeat a variation of that line to keep the bias open? Unless they are less sure now.

The BoC doesn't necessarily always think through wording shifts as carefully as they perhaps should, so maybe it's nothing.

Or maybe the Governing Council felt no need to repeat any such bias since markets are already leaning in the direction of another cut or more and not in need of a jolt.

It may also be that not repeating that line is also a signal they don't have confidence to go in a straight line but want considerably more data. That was the 2015 playbook when former Governor Poloz cut, skipped a rope behind the scenes, and then cut again.

Furthermore, when you're at the fine-tuning stages of monetary policy when you've already come down to basically a zero real policy rate and well inside their estimates of neutral, you can take more time, require more evidence, barring clearer and bigger shocks ahead especially as trade and fiscal policy are very much up in the air.

Overall, I still like another cut this year and see nothing obvious here that they've signalled against that view, but at least October relative to December seems a bit richly priced imo based on current information.

OTHER REASONS FOR WHY A SKIP MAY BE IN THE CARDS

That's not enough to hang an October pause call on.

October meeting pricing might also be too rich because of frequent references to the federal Budget on November 4th—after the next BoC decision on October 29th when they next issue a full forecast update. See the press conference transcript later in this note.

Further, Governor Macklem's opening remarks to his presser indicated high uncertainty about the path forward for cost and price pressures:

"Looking ahead, the disruptive effects of shifts in trade will continue to add costs even as they weigh on economic activity. Governing Council is proceeding carefully, with particular attention to the risks and uncertainties. "

He expanded on this uncertainty in his press conference.

FULLER STATEMENT COMPARISON

See the appendix for a comparison of this statement with the previous one in July.

On the additions side, there is clearly more concern about the global and US economies as expected. Ditto about the Cdn job market with explicit reference to two months of declines. Flagged GDP, but not as much emphasis upon robust final domestic demand as I might have expected.

But on the omissions side and as noted, key is the bottom right paragraph in the earlier statement that's gone as flagged immediately in my client chats. A meek attempt at forward guidance in the prior statement is now replaced by basically nothing.

I'm encouraged to see them continue to move away from referencing the y/y trimmed mean and weighted median gauges in favour of m/m SAAR. It's about time. The y/y TM and WM measures are slow moving, m/m weighted and compounded measures that each month take in only one new month and drop the first month while adding any revisions to SA factors. It's not a spot y/y calc. It's a m/m weighted slow moving measure. By the time that turns, it's lights out and you've reacted too late. The key is smoothed m/m SAAR TM and WM and other core measures which I've emphasized for ages but the BoC was slow to move to this

NOTHING SAID ON FUNDING MARKETS AND CORRA

As expected they did not do anything about funding issues. Nor should they have as I've written. See Q&A #6 in the press conference transcript below. There was no mention of funding markets in the statement itself or the published opening remarks.

That said, I thought SDG Rogers' answer was a bit weak. To blame CORRA widening largely on a bond settlement still seems like a stretch to me. The most predictable thing about Canadian fixed income markets is the BoC's bond maturity schedule that is publicly available and well understood. It wasn't an unexpected shock with no advance preparedness being possible unless mass sleep apnea suddenly struck trading desks. There were other plausible explanations for CORRA widening that I've flagged. One was the other explanation Rogers gave relating to hedge fund activity in Canadian funding markets and the impact around the period in which rate cut bets took off. Remiss from the rest of her answer was reference to correlated funding market challenges in the US and Canada and how the US may be in the driver's seat in terms of the integrated cross border influences. If so, then it may be the Fed's fight with the BoC as the spectator to potentially benefit vicariously from whatever the Fed may do about it. The BoC may not wish to address factors affecting another central bank, but that's not the same as saying we shouldn't.

PRESS CONFERENCE TRANSCRIPT

Here is an attempt at providing a transcript of the Q&A portion of the press conference that followed Governor Macklem's reading of his written remarks. Any errors or omissions are to be blamed on my typing abilities!

Q1. Was there a lack of conviction that the easing in inflationary pressure is sustainable and is that why your guidance is rather cagey?

A1. There was a clear consensus to cut by 25. We considered a hold or a cut. What tipped the balance in favour of a cut was the clear sense that the balance of risks has shifted. I outlined the main reasons for that. The inflation picture hasn't really changed a great deal since where we were last January. (ed. yes it certainly has for core m/m SAAR....). The more recent monthly measures on the core measures has come off. If you look at the inflation data there is more comfort that some of the upward pressures are easing off. There are still some mixed signals there. We know there are offsetting factors. The guidance really is we're not being as forward looking as normal and paying close attention to the risks and uncertainties. If those shift we're prepared to take action. [ed ie: no answer...lol]

Q2. Any thinking on fiscal policy?

A2. There have been a number of announcements of the most directly affected sectors. More recently there have been announcements on big projects. From our perspective, as those plans become more concrete we will be assessing their macroeconomic impact. The budget will be tabled on November 4th. It's less about individual measures and more about the overall macro impact. Once we have the budget we will be assessing the implications for the plans on the outlook and what we need to do with interest rates. [ed. waiting for the budget...]

Q3. You are cutting with core inflation at 3% and other measures at 2 1/2%. Aren't you taking some kind of a risk here with inflation pressures?

A3. Total inflation has been running below 2% largely because of the elimination of the consumer portion of the carbon tax. The more recent monthly readings have been running around 2 1/2% over the past three months. Other measures of core are similar. The percentage of the basket that is rising is roughly around where it is when inflation is running around 2 1/2%. At this point, inflation pressures look a little more contained and with a weakening economy that puts downward pressure on capacity and inflation we felt a cut was appropriate.

Q4. What would you need to see on inflation and employment to cut again this Fall?

A4. If there was just one thing the job would be so easy. Tariffs are weakening the Canadian economy. You can see that in the directly affected sectors. Employment growth has slowed in more of the economy. We will be looking at spillover effects across more of the economy. When we talk with businesses they are finding all new costs as their supply chains adjust. The reality is that tariffs increase trade frictions with our biggest trading partner and that has efficiency costs that monetary policy cannot offset. We can help the economy adjust while containing inflation. It's going to be about balancing those risks. If the risks tilt further we're prepared to take more action but we're going to take it one meeting at a time while being less forward looking than usual. We'll make that assessment in October when we get there.

Q5. Would you rather just wait and take a decision in December after you see the budget?

A5. If the Budget was the only thing happening that might make sense but we'll get a lot of new information between now and then. We're particularly focused on what's going to happen to exports; we saw a very sharp drop in Q2 because they were pulled forward and because of tariffs. Going forward we'll be watching very closely where exports go, how that spills over into the rest of the economy, where do those costs go and what happens to expected inflation. We'll be looking at the balance of risks. I expect we'll get more information on fiscal policy between now and our next decision but the Budget pulls it all together.

Q6. Are you considering a technical adjustment to the deposit rate given funding market pressures? Can you explain CORRA developments?

A6. Rogers answering. There have been a number of factors. One was the bond maturity that strained funding. The greater presence of foreign hedge funds in Canadian funding markets can be a bigger influence when there is a change in rate cut pricing. There is not plan to change the discount rate at this time. We expect turbulence as settlement balances get down toward our target rate but we have a number of tools we can use. [ed. summary: expect nothing on CORRA at least for quite a while]

Q7. General question about tariff effects and other drivers of inflation.

A7. You can see some effects of counter tariffs on categories like food and perishables. Canada has now dropped most of those counter-tariffs. You'd expect those prices to come back down. From a monetary policy perspective, the direct effect of tariffs is a once-off impact and level increase that we would tend to look through that. The risk to us is that a temporary increase in prices has knock on effects on other prices and then it becomes more widespread. The fact that the retaliatory tariffs have been removed takes off that second round effect. [ed. not all retaliatory tariffs are gone through.....autos and metals for instance. but Macklem does a better job on this issue than, say, the strident comments by Fed Gov Waller.]

Q8. How much of a role did the elimination of retaliatory tariffs plays in your decision?

A8. The upward momentum we were seeing in core measures earlier in the year has fallen off. That's telling us that the risk that the inflation pressures will go up further has gone down. The remove of retaliatory tariffs reinforces this. Those two things taken together and alongside a weaker economy tilted the balance today. You have to look at the combination of how all that fits together.

Q9. Ontario Premier Ford said 'good, now keep going.' Reaction? How much support was there on Governing Council for a deeper cut?

A9. We take evidence-based decisions independent of politics. There was a clear consensus on Governing Council to cut and I've outlined the reasons why.

Q10. If the Canadian economy fails to recover as rate cuts continue would QE be justified by Trump tariffs?

A10. We're a long way from there. We have a lot of room on our policy rate. The current tariff scenario expected slow growth that won't feel good but is growth as the economy adjusts to a different US relationship. In the escalation scenario where tariffs escalate, the Canadian economy goes into recession and the situation would be worse. Having said that, we'd still be a long way from QE. In the deescalation scenario growth and the recovery would be stronger.

Q11. How much of the uncertainty reflects trade versus fiscal policy uncertainty?

A11. Rogers answering. It's one of the things we consider. There is a lot of uncertainty. We'll have some time to digest the budget in our last decision of the year. Now Macklem intervening: the way the US has implemented tariffs applies to very specific sectors, same with Chinese tariffs on canola, pork and seafood. For the rest of the economy, tariffs remain very low providing you are compliant with CUSMA. The impact is very specific. Monetary policy is a blunt instrument that can help the economy adjust but we cannot help individual sectors. Fiscal policy can do that and there have been a number of supports introduced. Then there is a broader industrial strategy and business changes. We will be looking at what fiscal policy is doing and take it into account.

Q13. How are you thinking about lag effects of rate adjustments relative to immediate effects of trade shocks?

A13. Yes we do need to factor that in. The lagged effects of the cuts over the last year involve long and variable lags but before we got hit with tariffs we could see lower interest rates were feeding through the economy. Then come February we're hit with tariff threats and reversals and the consequences. Yes we have shortened our horizon in a situation of greater unpredictability but that doesn't mean we're not looking forward at all. We're using scenarios. Those scenarios have been very helpful in our decision making. We have seen some of the tariff uncertainty decline and outside of the most affected sectors tariffs remain low. I expect that if this holds we will be able to get back to a base case projection in October. We'll see.

Q14. Are there any foreseeable upcoming factors that could boost the risk of stagflation?

A14. Could see tariff policy change. We could see more indirect effects of tariffs as businesses pursue measures to protect themselves, re-routing supply chains, investing etc, with general pressure on prices. We'll wait to see what fiscal policy brings.

Q15. How else does the BoC see population growth impacting weakness in the economy and prolong the contraction caused by the trade war?

A15. Population growth adds to demand and supply. Lower population growth means less growth in consumer spending and less new workers looking for jobs so other things equal the UR doesn't go up as much. Over longer periods of time these demand and supply effects are balanced out. When population growth was too warm it was boosting housing and consumption and we're now seeing the other side of that. Historically population growth moved relatively smoothly and we had rules of thumb but we need to adjust those rules. The number of jobs required to keep up with new entrants is lower than historically for example. [ed — I'm still of the view that this is too benign as a viewpoint. Canada does not integrate new arrivals overnight. The immigration dividend can unfold over many years.]

RELEASE DATE: SEPTEMBER 17, 2025

The Bank of Canada today reduced its target for the overnight rate by 25 basis points to 2.5%, with the Bank Rate at 2.75% and the deposit rate at 2.45%.

After remaining resilient to sharply higher US tariffs and ongoing uncertainty, global economic growth is showing signs of slowing. In the United States, business investment has been strong but consumers are cautious and **employment gains have slowed. US inflation has picked up in recent months as businesses appear to be passing on some tariff costs to consumer prices.** Growth in the euro area has moderated as US tariffs affect trade. China's economy held up in the first half of the year but growth appears to be softening as investment weakens. Global oil prices are close to their levels assumed in the July *Monetary Policy Report* (MPR). Financial conditions have eased further, with higher equity prices and lower bond yields. Canada's exchange rate has been stable relative to the US dollar.

Canada's GDP declined by about 1½% in the second quarter, as expected, with tariffs and trade uncertainty weighing heavily on economic activity. Exports fell by 27% in the second quarter, a sharp reversal from first-quarter gains when companies were rushing orders to get ahead of tariffs. Business investment also declined in the second quarter. Consumption and housing activity both grew at a healthy pace. In the months ahead, slow population growth and the weakness in the labour market will likely weigh on household spending.

Employment has declined in the past two months since the Bank's July MPR was published. Job losses have largely been concentrated in trade-sensitive sectors, while employment growth in the rest of the economy has slowed, reflecting weak hiring intentions. The unemployment rate has moved up since March, hitting 7.1% in August, and wage growth has continued to ease.

CPI inflation was 1.9% in August, the same as at the time of the July MPR. Excluding taxes, inflation was 2.4%. **Preferred measures of core inflation have been around 3% in recent months, but on a monthly basis the upward momentum seen earlier this year has dissipated. A broader range of indicators, including alternative measures of core inflation and the distribution of price changes across CPI components, continue to suggest underlying inflation is running around 2½%.** The federal government's recent decision to remove most retaliatory tariffs on imported goods from the US will mean less upward pressure on the prices of these goods going forward.

With a weaker economy and less upside risk to inflation, Governing Council judged that a reduction in the policy rate was appropriate to better balance the risks. Looking ahead, the disruptive effects of shifts in trade will continue to add costs even as they weigh on economic activity. Governing Council is proceeding carefully, with particular attention to the risks and uncertainties. Governing Council will be assessing how exports evolve in the face of US tariffs and changing trade relationships; how much this spills over into business investment, employment, and household spending; how the cost effects of trade disruptions and reconfigured supply chains are passed on to consumer prices; and how inflation expectations evolve.

The Bank is 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: July 30, 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%.

While some elements of US trade policy have started to become more concrete in recent weeks, trade negotiations are fluid, threats of new sectoral tariffs continue, and US trade actions remain unpredictable. Against this backdrop, the July *Monetary Policy Report* (MPR) does not present conventional base case projections for GDP growth and inflation in Canada and globally. Instead, it presents a *current tariff scenario* based on tariffs in place or agreed as of July 27, and two alternative scenarios—one with an escalation and another with a de-escalation of tariffs.

While US tariffs have created volatility in global trade, **the global economy has been reasonably resilient.** In the United States, the pace of growth moderated in the first half of 2025, but **the labour market has remained solid. US CPI inflation ticked up in June with some evidence that tariffs are starting to be passed on to consumer prices.** The euro area economy grew modestly in the first half of the year. In China, the decline in exports to the United States has been largely offset by an increase in exports to the rest of the world. Global oil prices are close to their levels in April despite some volatility. Global equity markets have risen, and corporate credit spreads have narrowed. Longer-term government bond yields have moved up. Canada's exchange rate has appreciated against a broadly weaker US dollar.

The *current tariff scenario* has global growth slowing modestly to around 2½% by the end of 2025 before returning to around 3% over 2026 and 2027.

In Canada, US tariffs are disrupting trade but overall, the economy is showing some resilience so far. After robust growth in the first quarter of 2025 due to a pull-forward in exports to get ahead of tariffs, GDP likely declined by about 1.5% in the second quarter. This contraction is mostly due to a sharp reversal in exports following the pull-forward, as well as lower US demand for Canadian goods due to tariffs. Growth in business and household spending is being restrained by uncertainty. Labour market conditions have weakened in sectors affected by trade, but employment has held up in other parts of the economy. **The unemployment rate has moved up gradually since the beginning of the year to 6.9% in June and wage growth has continued to ease.** A number of economic indicators suggest excess supply in the economy has increased since January.

In the *current tariff scenario*, after contracting in the second quarter, GDP growth picks up to about 1% in the second half of this year as exports stabilize and household spending increases gradually. In this scenario, economic slack persists in 2026 and diminishes as growth picks up to close to 2% in 2027. In the *de-escalation scenario*, economic growth rebounds faster, while in the *escalation scenario*, the economy contracts through the rest of this year.

CPI inflation was 1.9% in June, up slightly from the previous month. Excluding taxes, inflation rose to 2.5% in June, up from around 2% in the second half of last year. This largely reflects an increase in non-energy goods prices. High shelter price inflation remains the main contributor to overall inflation, but it continues to ease. Based on a range of indicators, underlying inflation is assessed to be around 2½%.

In the *current tariff scenario*, total inflation stays close to 2% over the scenario horizon as the upward and downward pressures on inflation roughly offset. There are risks around this inflation scenario. As the alternative scenarios illustrate, lower tariffs would reduce the direct upward pressure on inflation and higher tariffs would increase it. In addition, many businesses are reporting costs related to sourcing new suppliers and developing new markets. These costs could add upward pressure to consumer prices.

With still high uncertainty, the Canadian economy showing some resilience, and ongoing pressures on underlying inflation, Governing Council decided to hold the policy interest rate unchanged. 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 related to tariffs and the reconfiguration of trade. **If a weakening economy puts further downward pressure on inflation and the upward price pressures from the trade disruptions are contained, there may be a need for a reduction in the policy interest rate.**

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 from tariffs and trade disruptions 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.

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