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CANADA

A dovish-leaning hold by the Bank of Canada

The Bank of Canada held rates steady at 2.25%, but sounded relatively relaxed for now on inflation risks. At the same, there are lingering concerns about the jobs market and USMCA renegotiations. We share those concerns, and in our baseline scenario expect no hike this year, alongside only a gradual decline in USD/CAD over the remainder of this year



Bank of Canada Governor, Tiff Macklem

Jobs and USMCA concerns keep BoC slightly dovish

The Bank of Canada left its policy rate at 2.25% as expected, but the overall tone of the accompanying statement leant somewhat dovish relative to market expectations. The BoC acknowledged the impact higher energy prices were having on headline inflation and inflation expectations, and Governor Tiff Macklem said that a hike might be needed if oil prices were to remain elevated for a long period. However, the Bank also emphasised that core inflation has behaved well and that the proportion of components of CPI that are above target has declined.

Meanwhile, the jobs market is still described as “soft” with weak hiring and job losses seen in sectors exposed to US tariffs. Growth projections also remain modest, with 1.2% GDP growth

predicted for this year, 1.6% next, and 1.7% in 2028. Those 2027 and 2028 forecasts are a tenth of a percentage point below the consensus growth estimates.

While higher energy prices are a boon for Canada's economy given it is a major net producer of oil and gas, the ongoing uncertainty about trade policy continues to hold back sentiment. The coming evaluations of the USMCA trade deal between Canada, the US and Mexico and the potential for the US to put more of a squeeze on trade partners prompted Governor Macklem to warn that if there are significant rule changes that harm Canada, then a rate cut may be required.

Our call is still for no hikes

As such, the BoC seems to be hedging its bets a little. For now, the Bank is prepared to "look through the war's immediate impact on inflation". Assuming oil prices come down, and US tariffs remain unchanged, "a policy rate close to current settings looks appropriate". The upside risk stems from a prolonged period of elevated inflation costs that starts to feed through into broader price increases, while the downside risk is increased trade restrictions with the US.

In terms of our view, our base case is that the Middle East situation will gradually ease, we see a slow resumption of tanker flows through the Strait of Hormuz over the next couple of months, and energy prices do indeed start to come down. We also see the potential for a tough period of talks over the USMCA deal that will leave a cloud of uncertainty over the economy and weigh on the jobs market. In this situation, we continue to favour stable policy rates through to the end of the year.

Dovish BoC restrains CAD

USD/CAD briefly traded on the strong side after today's BoC announcement, although market pricing didn't shift meaningfully. Expectations remain for a 25bp rate hike at the October meeting, so more hawkish than our baseline call.

Today's relatively dovish BoC endorses our end 2Q call for 1.37 in USD/CAD. We do see some downside risks to that forecast given resilience in equity markets and oil prices remaining more elevated than longer. But for now, we are assuming there will be a period of elevated uncertainty around USMCA renegotiations in June, leading to upward volatility in the pair.

We expect better CAD performance in 2H26, when a new USMCA deal could ultimately be agreed and the Federal Reserve should cut rates. We expect 1.34 by year-end in USD/CAD, with risks to the downside.

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