

Bank of Canada in holding pattern ahead of summer easing

There is a risk that the BoC turns a notch more dovish at the March meeting, given the lower-than-expected inflation figures. However, we only expect rate cuts to start in June, and take the policy rate 100bp lower by year-end. Conservative expectations on easing and the correlation with US rates bear risks for the Canadian dollar



Canada's macro picture remains mixed

The key story from the last Bank of Canada's policy meeting in January was the removal of the line, the Bank "remains prepared to raise the policy rate further if needed" from the accompanying statement. Nonetheless, there was little inclination to back the growing market expectations of interest rate cuts. The statement reiterated that "the Council is still concerned about risks to the outlook for inflation, particularly the persistence in underlying inflation" with the annual rate of CPI expected to slow only "gradually... returning to the 2% target in 2025".

The data since then has shown GDP coming in hotter for 4Q, retail sales being more robust and the jobs market remaining firmer than the market had been expecting. However, inflation undershot expectations with headline CPI now down to 2.9% from 3.4% in December (consensus was 3.3%)

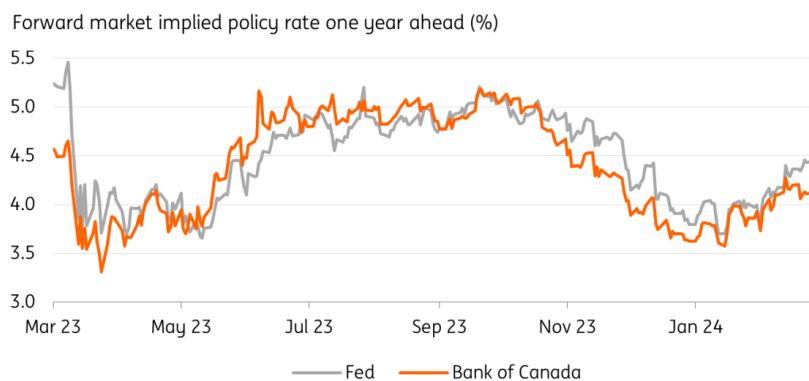
with core inflation rates slowing to 3.3% for the median and 3.4% for the trimmed versus the 3.6% rates that were expected.

But markets have scaled back cut bets

10Y government bond yields and the Canadian dollar are little changed since the January meeting, but we have seen the market scale back its expectations for rate cuts this year. Just after the 24 January decision, overnight index swaps were pricing around 105bp of BoC cuts for this year versus around 75bp today.

We believe this is more a reflection of the global repricing of interest rate moves with the Federal Reserve expected to be far more cautious on policy easing, rather than a meaningful re-evaluation of the prospects for the Canadian economy.

BoC rate expectations are strictly tied to the Fed



Source: ING, Refinitiv

BoC to stay put, but rate cuts should start in June

While there is little prospect of any rate cut at the 6 March meeting and we doubt the BoC will be comfortable enough to loosen policy at the following meeting on 10 April, we do expect interest rate cuts to start coming through from the 5 June meeting onwards.

We look for 100bp of rate cuts in 2024 with a further 75bp in 2025

The effects of previous rate hikes continue to feed through since Canadian mortgage rates will continue to ratchet higher for an increasing number of borrowers as their mortgage rates reset after their fixed period ends. This will intensify the financial pressure on households, dampening both consumer spending and inflation. Unemployment is also expected to rise given the slowdown in job creation (and rising job lay-off announcements) with high immigration and population growth rates adding to the slack in the labour market.

Consequently, we expect inflation to drop back to 2% in the second half of this year rather than in 2025 as the BoC expect, which will give the BoC the opportunity to move policy to a more neutral

level before anything painfully breaks in the Canadian economy. We look for 100bp of rate cuts in 2024 with a further 75bp in 2025.

Market implications

Markets are pricing in a 70% implied probability of a rate cut in June, and with three total cuts expected by year-end, we think investors are underestimating the size of BoC easing. Accordingly, we do expect soft economic data to give Canadian bonds relief at some point before the summer: as discussed above, that can come both from the Canadian side or from the US side.

In the shorter run, we suspect this meeting will not change the picture dramatically for CAD assets. Indeed, softer CPI could prompt the BoC to sound more optimistic on disinflation and start hinting at monetary easing more explicitly at the March meeting. Given the rather conservative market pricing on BoC rate cuts, we think the balance of risks is tilted to the downside for front-end CAD rates and the Canadian dollar next week.

Our core view remains, however, that the US dollar could enjoy more pockets of support as US data shows more signs of resilience in the near term, and the Canadian dollar should benefit in the crosses (especially against other commodity currencies).

CAD to lag NOK, AUD and NZD beyond the near term

Beyond the short-term, we are not as excited for the Canadian dollar as we are for the likes of Norway's krone, and the Australian and New Zealand dollars into a summer of monetary easing. First, because of our view of large easing by the BoC (unlike Norges Bank, and the Reserve Banks of Australia and New Zealand), and second because CAD shows some strong correlation with US data sentiment. Our bearish forecast for USD/CAD into year-end is primarily a mirror of USD weakness. We see 1.30 being tested this summer.

Authors

James Knightley

Chief International Economist, US

james.knightley@ing.com

Francesco Pesole

FX Strategist

francesco.pesole@ing.com

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies).* The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss

arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit <http://www.ing.com>.