

Bank of Canada leaves the door open to a June cut

Interest rate cut expectations have receded everywhere following the US inflation data, but there are subtle dovish incremental shifts within the BoC's commentary that suggest should inflation and unemployment continue with their current momentum then the BoC are open to a June rate cut. The Canadian dollar is facing more downside risks



Tiff Macklem, governor of the Bank of Canada

Cautious optimism on inflation

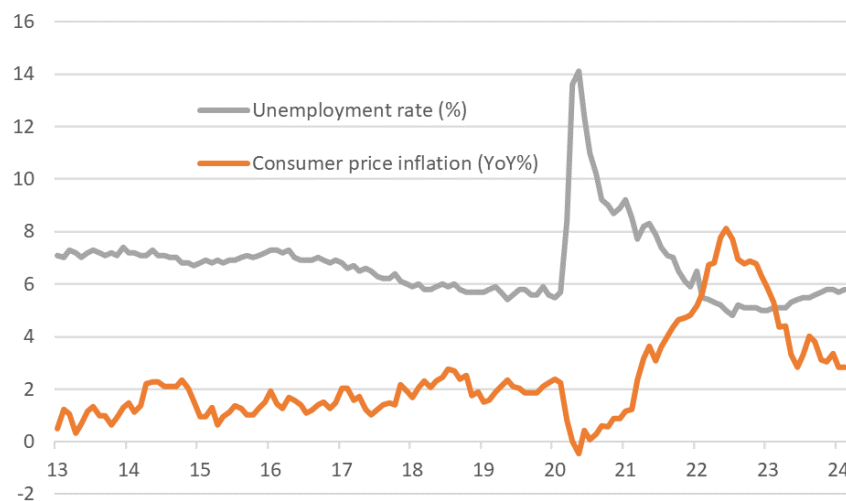
The Bank of Canada has left the target for the overnight rate at 5%, in line with market expectations, and is continuing with its policy of quantitative tightening. Nonetheless, there are subtle dovish shifts.

The statement acknowledges that “a broad range of indicators suggest that labour market conditions continue to ease” and with the workforce growing more quickly than those employed, we are seeing a rise in the unemployment rate, which is helping to moderate wage pressures. The BoC do expect growth to “pick up in 2024” after having stalled in the second half of 2023, so while there is “excess supply” in the economy this will be gradually absorbed through 2025 and 2026.

This excess supply has meant an easing of price pressures in the economy and the BoC now expect CPI to move below 2.5% year-on-year in the second half of 2024 “and reach the 2% inflation target in 2025”. The BoC state that inflation “is still too high” but they appear to have adopted a slightly more dovish position, dropping the sentence “the Council is still concerned about the risks to the outlook for inflation, particularly the persistence in underlying inflation”. This has been replaced with “the Council will be looking for evidence that this downward momentum [in inflation] is sustained”.

In the press conference, Governor Tiff Macklem said a June rate cut is “within the realm of possibilities”.

Inflation and unemployment moving in the "right" direction



Source: ING, Macrobond

A June cut remains our base case

The pricing of a June rate cut has receded from 19bp at the start of the day to just 14bp currently, but we believe this is more a reflection of the surprise strength in today's US inflation report that has led to a scaling back of rate cut expectations everywhere.

The BoC is not afraid to move independently from other central banks and if we see the unemployment situation continue softening and inflation moderating we believe they will indeed carry through with a June rate cut.

CAD facing downside risks

With Bank of Canada's rate expectations still reflecting more the developments in the Fed pricing than the domestic backdrop, downside risks for CAD persist in our view. The proximity to a rate cut in Canada is in stark contrast with the reiteration of hawkish stances by the likes of Norges Bank and Reserve Bank of New Zealand, and we still expect CAD to lag most commodity currencies barring major shifts in risk sentiment.

When it comes to USD/CAD, the short-term outlook should continue to be driven by the USD leg. Despite today's rebound, USD was starting from an already cheap level after the recent repricing higher in Fed expectations, meaning there is more upside room for the greenback in the near term.

The widening gap between USD and CAD rates should help build a floor for USD/CAD as high as 1.3600. A move to 1.3750/1.3800 in the coming weeks is possible.

Authors

James Knightley

Chief International Economist

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>.