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Bank of Canada preview: A hold is slightly more likely

The USMCA exemption from tariffs means that the risks to the Canadian outlook have slightly abated. There is still a tangible risk that the Bank of Canada will cut rates again on 16 April, but we marginally favour a hold – also considering the proximity to federal elections. USD/CAD is cheap below 1.40, but the USD confidence crisis may take time to unwind



Bank of Canada building in Ottawa

Tariff exemptions may tilt the balance in favour of a hold

Markets and economists are split as to whether the Bank of Canada will cut interest rates again on 16 April. There is a very slim majority that favours a no-change outcome after 25bp cuts in January and March, but it could go either way.

On the one hand, recent activity data has beaten expectations, and inflation has ticked higher, and the BoC may want to keep some ammunition back, given the US tariff-related uncertainty. However, a weaker jobs report and concerns about future growth, given that 75% of exports go to the US, could justify another cut that would leave the policy rate at 2.50%.

Article | 14 April 2025 1 March CPI is released the day before the BoC decision, and we look for the year-on-year inflation rate to rise to 2.7% from 2.6%, with core inflation set to rise to 3%. Throw in the proximity to the election and the tariff carve-outs for USMCA-compliant goods, and we feel it would take a big downside inflation surprise to prompt a rate cut this week. We favour a no change decision, but given the risks to the economy from global trade tensions, we look for 50bp of additional cuts in subsequent months.

CAD still trading on the USD confidence crisis

While we narrowly expect a hold, the 30% implied probability of a cut seems slightly too hawkish. We don't exclude that markets may modestly increase bets of a cut going into the meeting, although much will depend on the CPI print on Wednesday.

While we expect a positive impact on the Canadian dollar from a hold, the implications for FX of this policy meeting aren't huge. The outlook for USD/CAD remains much more tied to how far the "sell America" sentiment (i.e. coordinated selloff of Treasuries and equities) will go rather than swings in rate differentials.

The 2-year swap spread has tightened in favour of CAD by only 20bp in April, and at 120bp remains too wide to justify USD/CAD below 1.40. Based on our estimates, the pair is trading 2% below its short-term fair value, which is largely in line with the USD-negative risk premium observed in other crosses.

We think a lot of damage has been dealt to the USD's safe-haven appeal, and even if trade risk is unwound further, the recovery in USD may only be gradual. We expect 1.40 to work as a gravity line for USD/CAD in the coming weeks, with volatility that may remain elevated for longer.

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