Bank of Canada growth concerns leave rate cuts on the table

The BoC left rates on hold as expected. However, there is greater emphasis on growth risks as the US and Canada still haven't agreed on a trade deal ahead of the 1 August deadline. We expect the BoC to cut rates at least once again this year, and the Canadian dollar to come under more pressure

We expect the Bank of Canada to resume cutting interest rates this year, potentially even twice

As anticipated, the Bank of Canada maintained its policy rate at 2.75% following renewed trade tensions and positive June data. Headline CPI increased to 1.9% in June from 1.7%, with employment growth coming in unexpectedly strong at 83k. However, the policymakers emphasised a weakened growth outlook. Despite consumer and business surveys reporting improvements, the Canadian economy looks set to have contracted in the second quarter: the BoC's 2Q GDP growth forecast of -1.5% is well below the latest consensus prediction of -0.5%. Amid increasing tariffs, exports to the United States fell, consumer spending weakened, and businesses remained cautious about investment.

If a trade deal is not reached by 1 August, the threatened 35% tariffs from President Trump will come into effect. While United States-Mexico-Canada Agreement (USMCA) compliant goods are exempt, sector tariffs on critical industries, including 50% tariffs on aluminium, steel and copper, and 25% tariffs on autos, will still apply. The Canadian economy has shown resilience. But if trade uncertainty persists, growth headwinds should continue into the third quarter.

Ahead of the next policy rate decision on 17 September, the Bank of Canada evaluates three tariff scenarios: current, de-escalation, and escalation, with each scenario uniquely affecting business investment, consumer spending, and export demand. As the Bank of Canada weighs these considerations, Governor Tiff Macklem has emphasised that "*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*".

We still believe markets are too conservative with their BoC pricing (15bp by year-end), and we expect the Bank of Canada to resume cutting interest rates this year, potentially even twice. If upcoming data endorses our call, we can expect the Canadian dollar's weakness to extend even without the contribution of an idiosyncratically stronger USD. Our USD/CAD target for end 3Q is 1.39, but we see risks extending to 1.40-1.41 in the near term.

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