

Tariffs and NAFTA keep Bank of Canada on hold

As expected, the Bank of Canada has held its policy rate at 1.25% amidst NAFTA uncertainty and the introduction of new US import tariffs



Source: Bank of Canada

1.25% Bank of Canada policy rate

As expected

The big question going into today's Bank of Canada meeting was whether policymakers would acknowledge the latest developments on trade, following President Trump's recent threat to impose import tariffs on steel and aluminium. With no further official announcement or details on the tariffs, it was always going to be tricky for the Bank of Canada to make explicit reference to them in their statement at this stage.

However, the Bank said “trade policy developments are an important and growing source of uncertainty” for both the Canadian and global outlook, implying that the tariffs certainly factored into this month’s decision.

Currently, the US is the destination for 86% of Canada’s steel exports and 88% of its aluminium exports. These new developments have led to threats of retaliation from Canada and Mexico, and will also add further pressure to NAFTA talks.

The seventh round of NAFTA negotiations ended on a mixed note. The US trade representative Robert Lighthizer showed his frustration by saying that the talks have not made the progress that many had hoped for in this round, going on to say that only six of the 30 NAFTA chapters have been closed.

The clock is ticking, with Mexican elections due to take place on 1 July, Ontario and Quebec scheduling elections later this year and US mid-term elections coming up in November. It was hoped that NAFTA negotiations would be wrapped up by the end of the eighth round of talks in April, but this is looking increasingly unlikely.

Until the NAFTA/tariff storm begins to blow over, we think the Bank will remain cautious. The latest mixed flow of economic data also takes some of the pressure off policymakers to act. But assuming the protectionist cloud begins to blow over later in the year, and core inflation continues to “edge up”, we expect the Bank of Canada to recommence its tightening cycle in the second half of the year.

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