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Bank of Canada Continues to Hold on Rates – For Now

As expected, the Bank of Canada held its policy interest rate at 5% for the sixth consecutive time at its April 10 meeting. The Bank's statement reflected a more subdued tone, highlighting a slowdown in underlying inflation and a loosening of labour market conditions. While slowing inflation is "becoming more broad-based across goods and services," the Bank is looking to see a sustainable decline in core CPI (Consumer Price Index).

Economic growth, however, is expected to be stronger than previous projections, with global growth for 2024 revised upward by 0.3% to 2.8% and pegged at 3% for 2025. Domestically, growth prospects have significantly improved, with a forecast of 1.5% for 2024 compared to the previous outlook of 0.8%.

As part of its statement, the Bank provided updated estimates on the neutral rate of interest and potential growth. The neutral rate of interest, while not directly observable, is a crucial factor in guiding monetary policy decisions. It represents the policy rate that maintains the economy at its potential output level while ensuring stable inflation.

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The Bank of Canada uses four different models to estimate Canada's neutral rate of interest. Due to the variety of models used, the Bank has published a 100 basis point band for the Canadian neutral rate. Given Canada's status as a small open economy, most of these models rely on the US neutral rate as a key input. Consequently, Canada's rate tends to track closely with the US rate. Last year, the Bank signaled a potential "risk" of a higher neutral rate. Not surprisingly, the latest Monetary Policy Report revealed a 25 basis point increase in the neutral rate.

The Bank's estimate of the neutral rate has increased, but there remains a wide range of uncertainty surrounding this estimate. While the neutral rate is a useful tool for assessing monetary policy stance, it serves more importantly as an input for the Bank's forward-looking view on the economy rather than for setting specific monetary tactics. As the Bank eases its policy, it will closely monitor incoming data and the direction of the economy.

While potential growth for 2024 has been raised, primarily driven by robust population growth, projections for 2025 and 2026 have been revised downward due to expectations of a slowdown in population gains.

While the Bank hasn't declared victory on inflation yet, we continue to expect a rate cut as early as June.

ABOUT THE AUTHOR

KEVIN FETTIG
PRESIDENT OF CMI FINANCIAL GROUP

Kevin has had a long career in capital markets, housing finance, and public policy. He has worked as an economist for Alberta Treasury, Saskatchewan Policy Secretariat, the Bank of Canada, and the Department of Finance Canada. His work has included tax policy, economic forecasting, as well as monetary policy and debt management. While at the Bank of Canada, he authored two Bank of Canada Review articles on monetary policy tactics. Kevin has worked on a variety of debt programs from treasury bills to domestic and foreign bond issues, and interest rate swaps. He worked on building and managing the federal real return bond program, the Canada Savings Bond program, and built out the bond buyback program and a synthetic foreign funding program – two programs which are still in use today by the federal government. While at CMHC, Kevin managed the market funding program for social housing, built and managed the Canada Mortgage Bonds program, and expanded the products offered under the NHA MBS program. He has worked for several mortgage insurers including CMHC, Canada Guaranty, Triad Guaranty and Genworth. This work encompassed product development and risk management across housing markets in North America, Europe, Asia, Australia, and New Zealand. More recently he has had senior management roles with residential lenders managing underwriting, risk, product development, capital markets, and strategic planning.

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