

FMG QuickTake: June 2024 Policy Decision

June 5th 2024

Summary:

- The Bank of Canada **cut rate 25 bps** to 4.75%
- They described a more confident outlook for inflation
- Partly as a result of a weaker perspective on growth - meaning more slack in the economy
- But went out of their way to stress that cuts are still the *probable* outcome for 2024 (not definite)

Important Takeaways -

- **Where will rates go from here?**
Down for sure - but the timing? Still questionable
- **Will the BoC cut in July?**
The market is 68% priced. And one would think that it would be hard to get below 50% going forward unless the data is much stronger - especially CPI. That said - a July cut is far from a lock.
- **So when might we get cuts?**
Assuming that the data prints close to the new data projections in the Monetary Policy Report released at the July policy meeting (which will presumably be weaker than those in April's report) - then a steady diet of another 1 - 3 cuts in 2024 is very plausible

Observations -

Given the market had an 82% probability of a cut in the pricing - this move should hardly be a surprise. And yet - even we (and we did call for a cut) didn't think it was much more than a 60% probability. After All, this is the first cut in the G7, way ahead of any potential Fed move, and we had no clarity on just how much data was "enough data" for the BoC to act. However, we shall let the BoC summarize why this happened and what it means:

Describing the domestic economy:

- *Economic growth resumed in the first quarter of 2024 after stalling in the second half of last year. At 1.7%, first-quarter GDP growth was slower than forecast in the MPR.*
- *Overall, recent data suggest the economy is still operating in excess supply.*
- *Recent data has increased our confidence that inflation will continue to move towards the 2% target*
- *Governing Council agreed that **monetary policy no longer needs to be as restrictive***

Governor Macklem summarized:

- *"It is looking like a soft landing"*

Conclusions -

This was an All-Star performance by the Bank of Canada. And not just because they did exactly what we suggested that they might/should.

The challenge when changing the policy rate (especially for the first time in a potential cycle) is not usually with regard to that particular decision (it was 82% priced, after all). No - it is generally the reaction of the market with regard to projected future moves that keeps central bankers up at night. They do not want to spend their morning releasing their decision and their statement, follow that with a press conference, and then head back to their offices for a quick Chamomile tea and Tuna Poke Bowl working lunch to find that the market has misunderstood their message and is now pricing outcomes that the Bank of Canada sees as unlikely or aggressive. It creates more communication work for them and represents a potential mispricing of assets and the costs of capital.

By stressing that **this cut was an adjustment** (almost technical in nature and data dependent) - "*we do not require that level of restriction*" (5% rates) - and by following that up by stressing that each decision on future cuts is "*Meeting to meeting*" (ie not predetermined) - the BoC has limited the market expectations and produced realistic "street" projections.

And by going on to suggest that further cuts are likely if inflation keeps falling - but not back to levels seen before the pandemic - the **BoC is highlighting that a path to somewhat lower policy is ahead - but that is still data dependent.**

Bravo.

Market Reaction -

Rates are modestly lower across the curve.

The probability of a cut in July is currently 68%, with September at a cumulative 110%

Total rate cuts for 2024 from here are priced at two (53 bps to be precise)

The bond curve has "bull steepened" - with 2 year yields lower by 11 bps and 10 yr yields lower by only 6 bps.

The loonie is moderately weaker.

We generally refrain from commenting on movements in Foreign Exchange herein - our colleagues Kellett, Fricke, Guminski and Chan are far more qualified and interesting on that topic. However, with today the "first official day of divergence" and all eyes on what that means for our currency - its short run fortunes are a reflection of the rate move and the job that the Bank of Canada did on communication. *It has barely moved.* There has been nothing deemed inappropriate, nor aggressive here, and future guidance appears reasonable.

What Next? -

When the Bank of Canada next meets in July, a lot will have come to pass:

- We will have seen 2 more job reports
- We will have seen another CPI report
- We will have seen another GDP report
- The Federal Reserve will have met and discussed the future of US monetary policy

All of these will enlighten the Bank of Canada and inform their next decision. They will also produce an updated Monetary Policy Report - with presumably lowered GDP forecasts, possibly higher unemployment forecasts and a general sense that more slack than projected in April has opened up in the economy over the last 6-9 months as a result of the restrictive policy setting that we have been experiencing.

This will likely have implications for their path for inflation (lower). So, if the data between now and then obliges, this document could explain another cut. Or, it could explain a pause with a view to more cuts if the data plays out. Again, bravo. Take your flowers, Tiff and Co. This is a tough stage of the race and you've got the yellow for the day after pulling away from the rest of the G7 peloton (the ECB will probably finish second as early as tomorrow). With your training partner, the Fed, bonking and dropped - that is impressive.

The market appears fairly priced for now. The data will drive the next move. The danger is further divergence between the Canada and US rate curves - but at 79 bps in the 2 year part of the curve - there is already a lot priced in.

Government of Canada Bond Yield Summary							6/5/2024
		Last	1w chg (bps)	12m chg (bps)	3m High	3m Low	% Rank of Current Yld to 3m Range
GoC Bond Yields	2y	3.941	-32.70	-44.20	4.360	3.941	0%
	5y	3.426	-33.90	-11.90	3.905	3.399	2%
	10y	3.389	-31.10	11.10	3.868	3.330	6%
	30y	3.294	-25.40	12.40	3.743	3.239	6%
Curves	2s10s	-55.20	1.60	55.30	-47.70	-73.00	72%
	5s30s	-13.20	8.50	24.30	-10.30	-22.90	74%

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