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Posthaste: Canada's interest rates could fall more than many on Bay Street think

Economy shooting off too many troubling flares for this pair of prognosticators

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Carolyn Rogers, senior deputy governor of the Bank of Canada, left, and Tiff Macklem, governor of the Bank of Canada, arrive for a news conference in Ottawa on Wednesday, Oct. 23, 2024, after the central bank announced fourth consecutive interest rate cut. PHOTO BY DAVID KAWAI /Bloomberg

A couple of well-known economists are predicting the Bank of Canada will end up cutting interest rates lower than many have forecast as weakness in the economy continues to accumulate.

Wednesday's jumbo-sized 50-basis-point cut left the central bank's benchmark lending rate at 3.75 per cent, still well above the 2.25 per cent to 3.25 per cent range for its neutral rate, which is where the cost to borrow neither speeds up nor slows down the economy.

But with the economy shooting off troubling flares in different areas, economists at Rosenberg Research & Associates Inc. and Royal Bank of Canada are calling for interest rates to fall to two per cent or even lower by the middle of next year as policymakers respond to those emergency signals.

"A policy rate above the neutral rate is totally incongruent for an economy in a state of lingering excess supply," David Rosenberg, founder of Rosenberg Research, said in a note on the Bank of Canada's rate cut. "Such a condition augurs for a rate no higher than two per cent, and quite possibly lower."

Claire Fan, an economist at Royal Bank of Canada, echoed Rosenberg's assessment that this rate-cutting cycle should end at two per cent given the building signs of stress in the economy.

"In terms of the terminal level of interest rates, we think the BoC will cut to two per cent by July next year, stimulative and a touch below the lower bound of the (Bank of Canada's) own estimates of (a) neutral rate at 2.25 per cent to 3.25 per cent," she said in a note on Wednesday.

Among the other Big Six banks, terminal rate forecasts range from 2.25 per cent at Toronto-Dominion Bank and Canadian Imperial Bank of Commerce to 2.5 per cent at the Bank of Montreal to three per cent at the Bank of Nova Scotia. The latter forecast is more in line with current market predictions for a terminal rate of 2.75 per cent to three per cent, according to Bloomberg data.

So what are the economic stressors pushing Rosenberg and Fan into outlier territory?

Fan at RBC is calling for gross domestic product (GDP) growth of 1.3 per cent in 2025, well below the Bank of Canada's fresh forecast in the latest Monetary Policy Report of 2.1 per cent. For this year, RBC expects GDP to come in at approximately one per cent while the central bank has it at 1.5 per cent.

Canada's largest bank also expects the unemployment rate to rise to seven per cent "in the coming quarters and for softening activities combined to bring more disinflationary pressures in 2025," Fan said.

The unemployment rate is currently 6.5 per cent.

Rosenberg's economic red flags include the ongoing reference in several Bank of Canada statements, including Wednesday's, about "excess supply" in the economy, which indicates more is being produced than consumed. Policymakers said they expect that condition to persist into 2026.

"When we model this situation out, it implies a peak unemployment rate of eight per cent this cycle and a zero per cent inflation rate from 1.6 per cent currently and light years away from the 8.1 per cent cycle peak," he said.

Rosenberg noted that pre-COVID-19, the interest rate was 1.75 per cent and there was no "disinflationary output gap" of the economy producing less than it can, while GDP and inflation were lower, but unemployment was higher.

"The path of future rate cuts may be open for debate," he said. "But the destination is not."