Global News – December 11, 2024

Bank of Canada cuts rates by half a point but signals ‘more gradual’ pace

Craig Lord || December 11, 2024

The Bank of Canada delivered a second consecutive interest rate cut of half a percentage point on Wednesday, but signalled the pace of easing may slow as uncertainty builds in the Canadian economy.

The central bank’s policy rate now stands at 3.25 per cent after the fifth rate cut in a row.

The move was widely expected by markets and economists amid signs of a slowdown in Canada’s economy.

Bank of Canada governor Tiff Macklem said Wednesday that with the central bank now having “substantially” cut its policy rate since June, Canadians should not expect as rapid a pace of cuts.

“We anticipate a more gradual approach to monetary policy if the economy evolves broadly as expected,” he said.

Macklem confirmed that the Bank of Canada is considering “further reductions in the policy rate.”

But he did not provide much more specifics when asked by reporters about whether that means monetary policymakers will revert to more typical 25-basis-point steps at future meetings or whether a pause in the rate-cut cycle was in the cards.

“What does a more gradual approach mean? Well, we’ve just cut by 50 basis points at the last two meetings. So more gradual is more gradual than that,” he said.

What's next for the Bank of Canada in 2025?

The central bank’s policy rate broadly sets the cost of borrowing in Canada and is a key input for interest rates Canadians pay on their mortgages and other loans. Monetary policymakers raise the rate to slow spending in the economy and tamp down inflation, and reduce it when it’s time to stimulate growth again.

The latest half-point cut brings the Bank of Canada's policy rate to the top end of its "neutral" range, where the cost of borrowing is viewed as neither overly restricting or stimulating the economy.

Macklem said that with inflation back at two per cent, it's clear the Bank of Canada's benchmark rate no longer needs to be in "restrictive" territory, and said past interest rate cuts are starting to provide a lift to household spending.

Benjamin Reitzes, BMO's director of Canadian rates and macro strategist, tells Global News that, usually, when a central bank cuts interest rates so sharply in such a short span, it can signal an "emergency economic situation."

But he says that in this case, interest rates were just much higher than where they should have been with inflation more or less tamed and the economy starting to show cracks.

"It was time to bring interest rates back to a more neutral level, and so with this latest 50-basis-point move, we are at least in that range," he says.

RBC economist Claire Fan said in a note to clients on Wednesday that she expects the Bank of Canada will continue to lower its policy rate all the way down to two per cent before ending the current easing cycle in a bid to reignite the sluggish Canadian economy.

CIBC chief economist Avery Shenfeld said in a note that he also sees the Bank of Canada continuing to lower its policy rate — albeit at a more modest pace of quarter-point cuts — until reaching a low of 2.25 per cent in 2025.

BMO also has a 25-basis-point cut in its forecast for the Bank of Canada's first interest rate decision of 2025 on January 29. But Reitzes says the central bank has also opened the door up to a potential pause at its next decision, should upcoming economic data show less urgency for lower borrowing costs.

Currency markets are pricing in a 70-per cent chance of a 25-basis-point rate cut in January, according to Reuters.

The Canadian dollar, which had been floundering heading into the interest rate decision, rose a few tenths of a cent compared to the American greenback Wednesday morning amid hints of a slowdown in the easing cycle.

When the Bank of Canada's policy rate diverges from that of its counterpart south of the border, the U.S. Federal Reserve, the widening gap tends to hurt the value of the loonie. Recent economic developments in the U.S. have reined in market expectations for how steeply the Fed will cut its own interest rates.

Reitzes says that while the Bank of Canada did deliver an oversized rate cut on Wednesday, it was already priced in, and signs of a slowing pace of easing going forward helped to put a floor under the struggling Canadian dollar.

“What they’ve done is they’ve taken away some of the downside risk to the Canadian dollar, which was quite worrisome as it had been consistently weakening over the past number of weeks and months,” he says.

That may come as a relief for Canadian travellers heading to the U.S. over the holiday and for grocery shoppers at home, Reitzes notes, as a significant proportion of food is imported into Canada from south of the border during the winter.

Economic outlook is 'clouded'

While inflation has returned to the Bank of Canada’s target of two per cent, the Canadian unemployment rate rose more than expected in November and real gross domestic product undershot the central bank’s most recent forecasts in the third quarter.

Macklem on Wednesday signalled that the Bank of Canada is also expecting growth to come in weaker than expected in the final quarter of 2024.

He also pointed to significant new sources of uncertainty in the Canadian economy and emerging dynamics that will have impacts on the inflation outlook. These include the federal government’s two-month GST holiday and the threat of tariffs imposed by United States president-elect Donald Trump when he takes office in January.

He added that the economic outlook is “clouded” by whether the tariffs on Canadian exports are actually applied and to what degree, and whether Canada responds with retaliatory tariffs in kind.

Trump has floated imposing blanket tariffs of up to 25 per cent on both Canada and Mexico when he returns to the Oval Office, a move economists have said would hammer both the Canadian and U.S. economies.

If Trump makes good on his word, Reitzes warns the Bank of Canada would need to pivot dramatically to stimulate the economy with lower rates.

“They’d likely be quite aggressive on rate cuts at that point, a 25-per cent tariff would be extremely harmful to the Canadian economy,” he says.

On Ottawa’s plan to waive the GST and HST on certain grocery items and other household goods for a two-month span, Macklem said he expected that relief would lower inflation to around 1.5 per cent in January, but he noted that effect would be “unwound” after the tax “holiday” ends in mid-February.

Macklem said that the central bank would “look through effects that are temporary and focus on underlying trends to guide its policy decisions.” He said that inflation is likely to remain around two per cent, on average, “over the next couple of years.”

Meanwhile, there are signs that some Canadian housing markets saw an uptick in sales activity in November following the Bank of Canada’s first half-point cut of the cycle.

Senior deputy governor Carolyn Rogers told reporters on Wednesday that the central bank expects “some more pickup” in 2025 amid the sharp drops in the policy rate and mortgage changes coming from the federal government aimed at making it easier for some buyers to break into the housing market.

She noted that uptick in sales has come without a surge in home values.

But Reitzes projects that Ottawa’s mortgage moves and the lower borrowing costs will “juice activity” in the housing market further next year, and that prices likely won’t be far behind.

“Prices do tend to lag home sales activity. So assuming home sales stay relatively solid here, you are probably going to see prices react as we work our way through 2025,” he says.

On the opposite end of the spectrum, Rogers said that Ottawa’s plans to curb the pace of immigration in future years could have a “counterbalance” effect on housing demand.

“We’ll have to keep an eye on it,” she said. “But so far, an increase in activity without an increase in prices is a good thing for the Canadian economy right now.”

Macklem also said on Wednesday that the slower pace of population growth is expected to take more steam out of the economy in the coming years, limiting a rebound in GDP. He maintained, however, that the Bank of Canada is still not expecting the Canadian economy to fall into a recession.

The Bank of Canada will be out with new forecasts taking into account these myriad of factors when it makes its next interest rate decision on Jan. 29.