Bank of Canada September meeting recap: holding steady amid trade headwinds

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As widely expected, the Bank of Canada held the overnight rate at 2.25% for a seventh consecutive meeting in September, despite a widening of risks on both sides of the central bank's inflation mandate from an escalation in US tariffs and persistently higher energy prices.

The central bank (unsurprisingly) views further indications of a broadening economic recovery in backward looking economic data since the last policy decision as good news, with GDP growth bouncing back in Q2 and the unemployment rate drifting lower into July.

The policy statement did note some tightening in broader financial conditions from higher bond yields since the last policy decision. But the performance of economic indicators over the last month and a half argues that the level of interest rates currently is supportive enough to, all else equal, allow the economy to continue to recover and unemployment to drift lower from levels that are still relatively elevated.

Our own base-case remains that the BoC will leave the overnight rate where it is through 2026. We assume gradual interest rate hikes in 2027 but conditional on the Canadian economic backdrop continuing to improve.

Band of uncertainty around economic (and inflation) outlook widening

Still the BoC also addressed the clear escalation of risks on both sides of their inflation mandate since July with new U.S. tariffs on about 5% of Canadian exports adding to downside economic growth risks, but higher energy prices pushing up global energy inflation, including in Canada.

This is essentially a return to the two-sided interest rate risks highlighted in policy decisions from April to June following a brief reprieve at the last meeting in July when risks around the BoC policy rate were broadly judged to have narrowed.

BoC reiterating limits of monetary policy to address economic shocks

Governor Macklem's opening statement was also clear that "monetary policy cannot offset the effects of tariffs or influence global energy prices."

Fiscal policy is objectively a more effective policy tool to address targeted economic impacts from tariffs than blanket BoC interest rate changes, and Governor Macklem also argued that federal support programs will "likely mitigate some of the harm"

In terms of global energy prices, there is nothing that the BoC can do to impact the global price of oil.

But current shocks could still evolve in a way that would warrant a central bank response

Still, in both cases, there would be room for the BoC to respond were those shocks to spread across additional sectors/products to impact broader inflation trends.

On the trade front, increased trade uncertainty could weigh broadly on consumer and business spending in a way that would increase slack in the economy and cause underlying inflationary pressures to ease (arguing for lower interest rates for longer).

On the global energy price front, higher energy costs could spread to increase costs for a wider array of consumer goods and services, and those risks grow the longer energy prices remain elevated (and potentially arguing for higher interest rates.)

With uncertainty high, the BoC will remain highly data dependent

Like (it appears) the Bank of Canada, neither of those risks have changed our own base-case economic outlook.

There has been limited spillover of higher energy prices to-date into the prices of other consumer goods and services.

And Canadian consumers and businesses have shown signs of adapting to life under increased trade uncertainty — business investment strengthened in Q2 and consumer spending has remained resilient.

We remain cautiously optimistic that the Canadian economy will continue to gradually improve and the unemployment rate will drift gradually lower.

Contingent on that improving economic outlook being realized, we expect the BoC will be in a position to gradually raise interest rates from currently low levels beginning in 2027.

But the BoC is clearly still highly data dependent and the evolution of interest rates will depend on the path of domestic Canadian growth and inflation data.

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