25 October 2024

FX Viewpoint

Currencies
Global

CAD: The BoC's fourth cut, but this time by 50bp

- The BoC cut rates by 50bp in October, with 125bp of easing delivered year-to-date, getting ahead of other G10 peers
- Beyond the knee-jerk reaction, USD-CAD could drift higher in the run-up to the 5 November US elections…
- …but this momentum may not extend into 2025 when other factors supersede political forces as the key FX drivers

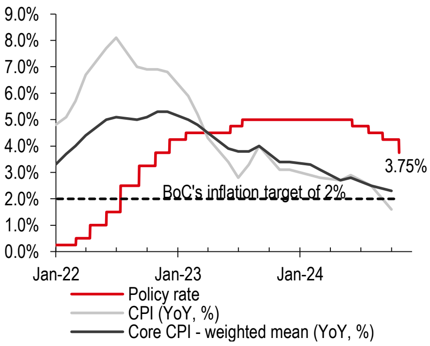
The BoC delivered an outsized cut of 50bp in October, in line with market expectations

On 23 October, **the Bank of Canada (BoC) quickened its easing pace** by cutting its policy rate by 50bp to 3.75%. This was the fourth consecutive cut this year. With 125bp of easing delivered year-to-date, the BoC has become the most dovish G10 central bank. **The BoC has now turned cautious of inflation undershooting the 2% target**, with core inflation below 2.5% and headline inflation of 1.6% in September (Chart 1). Meanwhile, business sentiment remains weak and GDP on a per capita basis continues to decline. **Our economists expect another 50bp cut in December, followed by 75bp of easing in 1H25**.

USD-CAD could drift higher in the run-up to the 5 November US elections…

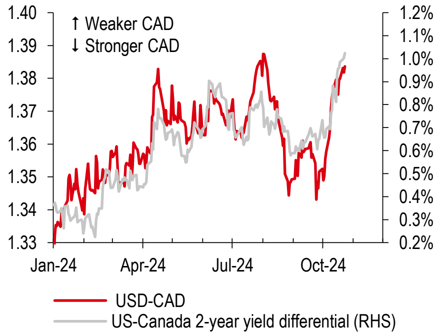
With the 50bp move fully priced in by markets, the knee-jerk pop higher in USD-CAD did not last. Looking beyond the BoC's announcement, we expect moves in USD-CAD to be driven mostly by USD sentiment over the near term. **With the recent de-risking ahead of the 5 November US elections, USD-CAD could drift higher**.

1. Canada: Policy rate and inflation



Source: Bloomberg, HSBC

2. USD-CAD and its yield differential



Source: Bloomberg, HSBC

…but the post-election reaction may not set the tone into 2025

Nevertheless, once the election result is known, the next response in the FX market, may persist for days, weeks or months. A Republican presidency could see the USD strengthening, which could weigh on the CAD, while a Democrat presidency could see USD-CAD reversing lower. But **this post-result reaction may not set the tone into 2025** especially when other factors supersede political forces as the key FX drivers.

USD-CAD is likely to drift broadly sideways in 2025, closely following its yield differential, in our view

USD-CAD has been closely following its yield differential (Chart 2), and this will probably continue to be the case in 2025. In general, oil prices tend to influence the CAD only when interest rate markets are quiet. But this may not be the case, as the easing cycles continue, with the possibility of market recalibration. The other remaining driver to the CAD tends to be risk appetite. But unless there is a US recession (and associated risk aversion) or a global 'Goldilocks' story, i.e., the global economy shows signs of resilient growth with slowing inflation, (and associated risk appetite), there is little reason to assume that USD-CAD is about to get exciting.

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