Intermeeting Fed Cut Would Spark Speculation of 50 bps Bank of Canada Cut

13:45 01/11 (CEP News) Montreal – A weak domestic employment report and speculation that the U.S. Federal Reserve could cut rates as soon as Monday has market watchers wondering if the door may be open for a deeper than expected rate cut when the Bank of Canada meets Jan. 22 to set policy.

On Friday, Statistics Canada announced an 18.7k decline in employment in December. Later, RBC economists, led by Craig Wright, released a report saying the Bank of Canada will ease 25 basis points at the next three meetings.

Wright said that even though economists are virtually unanimous in calling for a 25 basis point cut to bring the overnight target to 4.00%, that could change if the Fed announces an emergency rate cut.

"I'd be surprised if the Fed were to go intermeeting, but there is talk they may well go Monday." Wright told CEP News.

Wright doesn't think a Fed move would force the Bank of Canada to do the same, but said it would fuel speculation.

"People would talk it up a bit more," he said.

Canadian fixed income traders in Montreal were already talking about the possibility.

"We think there is a good probability the Fed will act before Jan. 30. Now we're wondering if the Bank of Canada will follow them tick for tick," one trader said, adding that such a move would contribute to the strong recent bid in Canadian government bonds and steepen the curve.

Dale Orr, Canadian economist at Global Insight, said inflation worries are moderating but a 50 basis point cut could raise inflation expectations.

"I really don't think the Bank of Canada would do 50 [basis points]. I'd say the chance is 10% or 5%," he said.

Orr said the strong Canadian dollar and the one per cent cut to the goods and services tax will moderate inflation in the coming year but the Bank of Canada will remain concerned with high commodity prices and wage growth.

Gian Espejo, a senior dealer at GCI Financial Ltd, shares Orr's concern on inflation and said with the transition from David Dodge to incoming governor Mark Carney, officials will try to minimize volatility.

“It would be unusual for the BoC to cut by 50bps before Carney assumes the helm," Espejo said. "With core CPI running at 1.6%, there is some operational room for BoC to make an aggressive 50bps easing, but with headline CPI at 2.5%, it may be difficult for the bank to justify."

Nonetheless, he believes the Bank of Canada is prepared to ease in the coming months.

"The rest of the world catches a cold when the U.S. sneezes, and with Uncle Sam already looking for his tissues, you can bet Dodge and Carney already have some chicken soup heating up on the back burner," he said.

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