



June 16, 2026

**From:** Jeremy M. Kronick and Steve Ambler  
**To:** Interest Rate Watchers  
**Re:** THE UNCERTAIN TIMES CONFRONTED BY THE BANK OF CANADA

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The Bank of Canada held its policy rate constant at 2.25 percent last week, meeting market expectations. This was despite headline inflation increasing to 2.8 percent in April, up from 2.4 percent in March, near the upper end of the central bank's 1-to-3-percent control range.

The combination of muted price pressures beyond gasoline, and economic weakness in the form of essentially zero economic growth in the first quarter of this year, contributed to the decision to hold, which we think was the correct one.

The harder question is where the Bank goes from here.

Will inflation spread to more sectors, forcing interest rates up? Despite encouraging May labour data, will economic weakness continue to keep rates low as we face structural challenges and the upcoming review of the Canada-United States-Mexico Agreement? Or will the Bank keep the policy rate where it is and reassess the economy's potential after we get greater clarity around these major events?

We admit to being torn as some of the key underlying inflationary measures the Bank uses seem to be pointing in different directions. Some suggest headline inflation – which is what the Bank of Canada actually targets – will move back toward the 2-percent target, while other measures of inflation signal a continued rise in headline inflation.

Let's unpack the details.

The spike in headline inflation in April was driven mainly by gasoline prices, which increased by 28.6 percent year-over-year. Inflation for all items excluding gasoline was 2 percent, exactly hitting the target rate of inflation. The main driver of gasoline prices was, of course, the war in Iran, which pushed up global oil prices. The removal of the consumer carbon levy on April 1, 2025, led to a decrease in gasoline prices that month, making the year-over-year increase in gasoline prices in April, 2026, even larger.

Gasoline prices are traditionally among the most volatile components of the consumer price index, so they are excluded from the Bank's measures of core inflation, which by construction exclude volatile components.

CPI-trim and CPI-median inflation, currently the core measures most favoured by the Bank, moved down to 2 percent and 2.1 percent in April, down from 2.2 percent and 2.3 percent in March, respectively. Previously favoured measures of core inflation, including the CPIX, which excludes gasoline along with fruit, vegetables, fuel oil, natural gas, mortgage interest, inter-city transportation, tobacco products, and the effects of indirect taxes, moved down to 2.1 percent in April, from 2.5 percent in March.

The core measures are designed to measure underlying inflation and to give an idea of where headline inflation is headed over the short to medium term. Moderating core inflation should be a predictor of moderating headline inflation.

That gives the Bank some time to leave the overnight rate target untouched before it might have to lower it to prevent the downward drift in inflation from overshooting the 2 percent target. If the trade negotiations with the United States and Mexico fall through, leading to weaker exports and employment, the Bank may have to lower the policy rate sooner.

But the industrial product price index and the raw materials price index for April were pointing in the other direction. These measures matter because they capture the input costs facing producers, and sooner or later they are passed on to consumers.

The industrial index increased 11.4 percent year-over-year, while the raw materials index increased by a whopping 31.6 percent. Both increases were largely due to the impact of the war. The last time the industrial index posted double-digit growth was the stretch from March 2021 to August 2022, when headline inflation accelerated from just above target to a peak of 8.1 percent in June 2022.

These price increases will flow through the supply chain. The big unknown, then, is the geopolitics of the war in Iran. If the apparent agreement between the United States and Iran leads to rapid and complete reopening of the Strait of Hormuz the restored flow of petroleum, natural gas, fertilizer, and other important commodities, should help lower input prices. But if that certainty is not forthcoming, input prices could continue to increase.

The bottom line is that uncertainty remains high and the Bank of Canada is faced with weighing the importance of contradictory signals about future price movements. For now, holding was the right call.

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