

## Central banks still face a dilemma

5 April 2026

There is much less talk about central banks raising rates in response to the Middle East war. Instead, despite the US President's efforts to try to convince markets of a looming de-escalation, there are clear signs that an escalation is more likely in the short-term and these have led to markets placing more weight on downside economic outcomes.

The lack of transit through the Strait of Hormuz, and growing realizations that oil prices might remain elevated for several more weeks, if not months, concern about real global economic consequences are now front and center. Hence, the challenge facing central banks is becoming even more complicated.

Regarding inflation, central banks are mindful of what happened in 2022 and might be less willing to look through “transitory” supply shocks. On the other hand, the supply chain disruptions due to the war in the Middle East which are hitting a range of industries highlighting that the economic headwinds will remain severe for some time.

We can see the evolution of potential central bank moves in Bank of Canada CORRA futures, and Fed Funds futures.

### **Bank of Canada CORRA futures**

CORRA futures rose in the first half of March following the start of the war in late February,

The probability of a mid-year rate hike spiking between 18 and 20 March as BoC Governor Tiff Macklem highlighted after the BoC’ rate announcement on 18 March that the “*conflict in the Middle East has broadened the range of possible outcomes,*” with economic weakness coinciding and rising inflation creating a “*dilemma.*”

In fact, BoC DG Sharon Kozicki discussed just such a dilemma in a speech in early March:

*“Many people may find it surprising or counterintuitive that, at times, monetary policy needs to be tightened even when the economy is weak. Yet that is exactly the difficult trade-off we sometimes face.”*

*What is there might well be circumstances where the upward pressure on inflation/weak economy balance tips toward a rate hike.*

*“But generally, when a supply shock is expected to have large or persistent impacts on inflation, some degree of policy restraint will be needed to bring inflation back to target.”*

Hence, rate hikes are possible. Since the mid-month, however, the probabilities attached to rate hikes have declined. Inflation risks still linger, but downside risks to the economic outlook continue to mount.

Even so, CORRA futures still point toward a significant probability of two rate hikes — lifting the policy rate to 2.75% — before the end of this year. That said, there is still an active debate as to whether the Bank of Canada should leave the policy rate unchanged, with some suggesting that economic drag will help keep inflation expectations locked down and that higher rates could tip over a very vulnerable labour market.

### **Fed Funds futures**

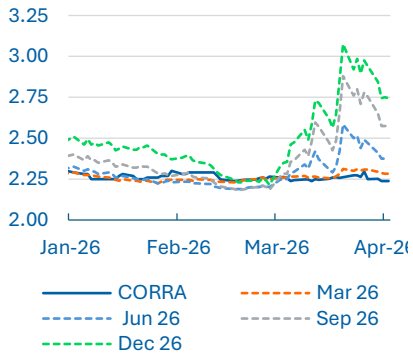
In the US, the market has swung from looking for rate cuts, to placing a high probability on a possible rate hike, to now, basically seeing an unchanged Fed Funds rate at 3.50% to 3.75%. The possibility of possible a possible rate hike followed hawkish comments by Fed Chair Jerome Powell following the FOMC meeting on 18 March. The probability of potential rate hikes rose above the probability of rate cuts. More notably, expectations of an unchanged Fed Funds target rate into year end became further entrenched.

The last chart shows the evolution of rate hike probabilities, with the probability that the Fed Funds target would rise to 3.75% to 4.00% or higher peaking at 43% on 26 March.

As of early April, the probability of a rate hike by year end has declined to effectively zero. With heightened concerns about potential negative economic damage from a lengthy closure of the Strait of Hormuz, the probability of a rate cut before year end has rebounded to around 25%.

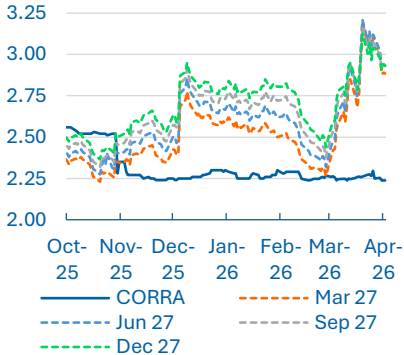
## Bank of Canada CORRA futures

Bank of Canada CORRA futures: 2026  
(implied rates, %)



Source: Toronto Stock Exchange, Watt Strategic

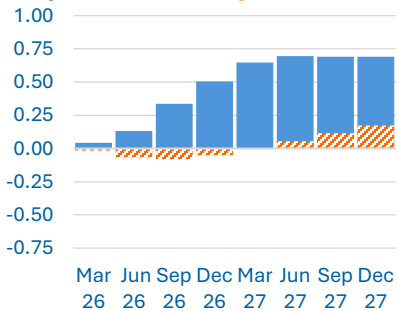
Bank of Canada CORRA futures: 2027  
(implied rates, %)



Source: Toronto Stock Exchange, Watt Strategic

Bank of Canada CORRA futures  
(basis points)

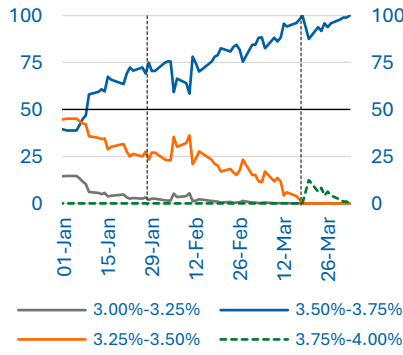
**2 April / 27 February**



Source: Toronto Stock Exchange, Watt Strategic

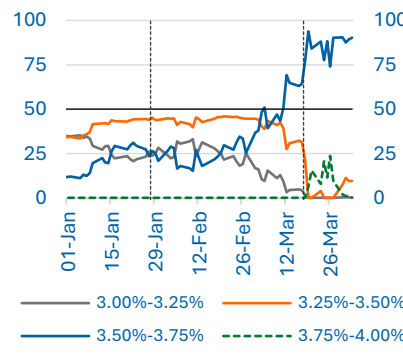
## Fed Funds futures

FOMC probabilities: 29 April 2026  
(%)



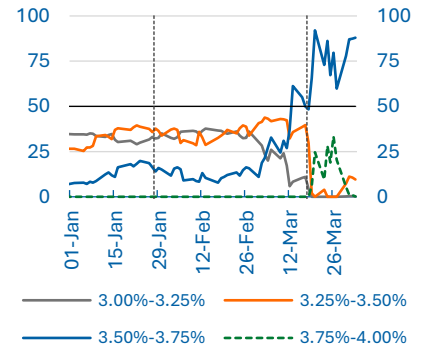
Source: CME FedWatch, Watt Strategic

FOMC probabilities: 29 July 2026  
(%)



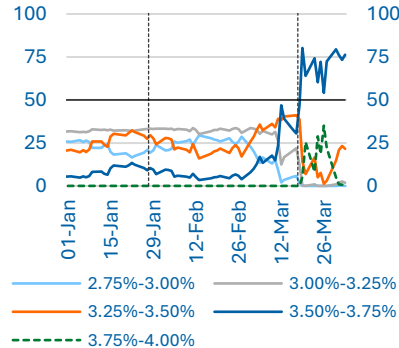
Source: CME FedWatch, Watt Strategic

FOMC probabilities: 16 September 2026  
(%)



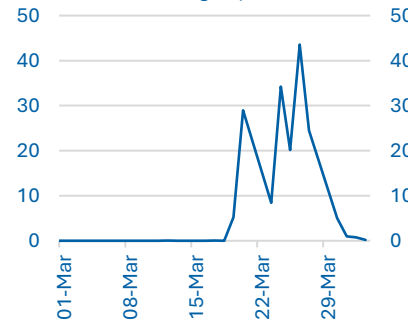
Source: CME FedWatch, Watt Strategic

FOMC probabilities: 9 December 2026  
(%)



Source: CME FedWatch, Watt Strategic

FOMC probabilities: 9 December 2026  
(%, fed funds target range  
3.75% to 4.00% or higher)



Source: CME FedWatch, Watt Strategic

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