

Bank of Canada edging towards action...

The Bank of Canada has left monetary policy unchanged, but the tone of the statement indicates heightened concern about the outlook for growth. Our December rate cut call had been looking very shaky, but today's announcement suggests it is certainly on the table



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No change, but a shift in tone

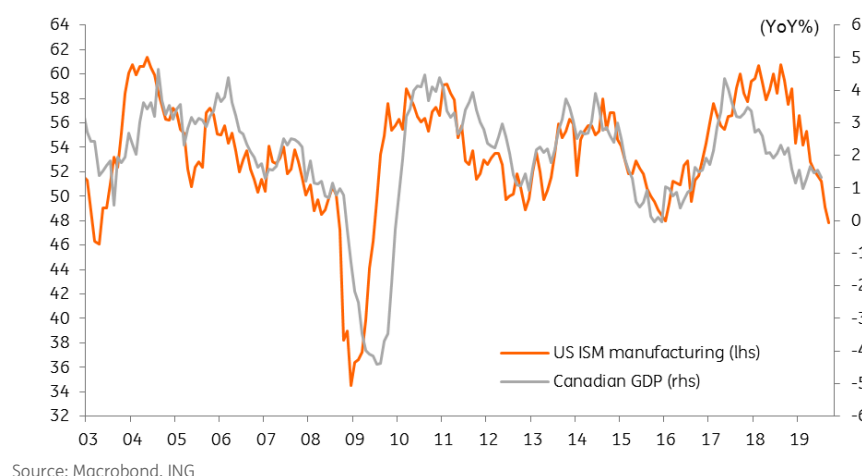
The Bank of Canada left its policy rate unchanged at 1.75% as widely expected, but there are clear hints of nervousness in the accompanying statement. It highlights the weakening global outlook with an acknowledgement that “Canada has not been immune to these developments”.

The statement goes on to say Canada's growth “is expected to slow in the second half of this year to a rate below its potential”, with business investment and exports expected to “contract” before recovering in 2020 and 2021. Consumer spending and government spending should still provide support to economic activity, but the “Governing Council is mindful that the resilience of Canada's economy will be increasingly tested as trade conflicts and uncertainty persist”.

In a clear shift from the September statement, the BoC states that the Bank will be “monitoring the extent to which the global slowdown spreads beyond manufacturing and investment” when assessing the outlook for monetary policy. Moreover, it will “pay close attention to the sources of resilience in the Canadian economy – notably consumer spending and housing activity – as well as

to fiscal policy developments.”

Where the US goes, Canada typically follows



Gearing up for a rate cut?

Ahead of today's announcement the chances of a rate cut at the December meeting were priced at around 12.5%. Now they are 25%. Meanwhile, the chance of a rate cut by next September has gone from 40% to 60%. We think that these probabilities are still too low. After all, the latest jobs report showed employment creation was all in the public sector with private-sector jobs falling 21,000. Additionally, the Ivey Purchasing Managers' Index fell into contraction territory while retail sales surprisingly fell 0.1% month-on-month in August versus expectations of a decent 0.4% gain.

Moreover, the global growth story is looking less positive with evidence spreading of a deceleration in US growth at a time when Europe's economy is stagnant and Asia's is softening. Canada is heavily exposed to these external threats given the Canadian economy is relatively open with trade accounting for more than 30% of economic activity versus little more than 10% for the US. Canada is also more dependent on commodities with mineral extraction and agriculture, representing more than 10% of the economy.

We also have to remember that the BoC has a tendency to move swiftly after signaling a shift in thinking. We can point to 2015 when the BoC rapidly changed its tune and cut rates in response to plunging oil prices and the fears for what it might mean for the broader economy. Recall, too, 2017, when it surprised with a September hike after already increasing rates in July. Swift, but modest action seems to be the BoC's mantra. We continue to see a decent chance of a surprise December BoC rate cut.

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