

Canadian growth rebounds as possible NAFTA deal edges closer

Today's GDP release has reaffirmed our view that the Bank of Canada will resume its hiking cycle as soon as trade uncertainties blow over



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0.4% GDP growth
MoM
Better than expected

The Canadian economy grew by 0.4% month-on-month, a little above market expectations, showing that growth has begun to rebound following a slow start to the year. We expect economic growth to remain strong over coming months, albeit with a moderation from last year's exceptional performance - the Bank of Canada (BoC) is forecasting 2% growth for 2018 and 2019. However, the recent interest rate hikes are likely to see a switch away from household spending, towards stronger contributions from business investment and exports.

Countdown to a NAFTA deal and a Bank of Canada rate hike

The threat of US tariffs on metals and the reworking of the North America Free Trade Agreement have been leading reasons as to why the BoC has not raised interest rates since January, and we do not see any monetary policy changes until these trade uncertainties have cleared.

The latest development is that the temporary exemptions on US tariffs given to Canada, Mexico and the EU were extended by President Trump hours before they were set to expire, with the new cut-off on 1 June becoming a de facto deadline for progress in the NAFTA negotiations.

This will come as a welcome relief for Canada and adds an incentive for a deal to be signed quickly. Forthcoming elections in all three countries and timelines related to US trade law (notably the upcoming expiry of the Trade Promotion Authority) mean negotiators are already keen to resolve differences sooner rather than later. The next big meeting between negotiators is set to take place on 7 May, after the US delegation's trip to China, however lower-level officials will be engaging to push negotiations forward in the meantime.

Given Canada's steady growth and firming inflation story we do not see the Bank of Canada hesitating if a NAFTA agreement is made, which remains our central expectation. As such, we see the Bank's hiking cycle recommencing in the second half of 2018 with two rate rises, starting in July.

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