5 December 2017
Snap

Bank of Canada to remain watchful

Uncertainties to keep the Bank of Canada on hold... but not for much longer

1%

Policy rate
Our forecast

October's Bank of Canada meeting saw interest rates being held at 1% following two prior consecutive hikes in July and September. This was followed by a speech from Deputy Governor Wilkins who provided the Bank's most detailed explanation as to why they are being more cautious regarding monetary policy tightening. The main thrust of the argument is that "during periods of uncertainty like today, a cautious approach may be prudent". These uncertainties notably being to do with NAFTA negotiations, which was explicitly referenced in their October press release, and the elevated level of household indebtedness, which is still the "most important vulnerability to the financial system" according to their most recent financial stability report.

Solid growth picture

The Canadian growth story continues to look robust with domestic demand growing at 3.7% annualised in the third quarter, only slightly below the first two quarters. The main drawback of the economy is currently exports which fell for the first time in over a year. However, this was anticipated following scheduled reductions in motor vehicle production and the unwinding of factors that temporarily boosted growth in Spring.

> The future outlook for growth is strong

The future outlook for growth is strong with the Bank increasing their forecasts for this year to 3.1% and 2018 to 2.1%. The economy is expected to continue to moderate and the stronger CAD is expected to have a dampening effect.

Inflation on the rebound?

Inflation is another aspect the Bank will have to consider. Governor Poloz (pictured) recently challenged the idea that inflation targetting has been ineffective following recent inflation softness, he reasoned that wage growth had been low because of continued labour market slack and changing demographics.

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Poloz expects inflation to close to 2% over the next several quarters. A slight pickup in inflation has been recently seen, October's figure coming in at 1.4%, reflecting higher gasoline prices, improving economic conditions and the drag in food prices dissipating.

The future of the Bank of Canada

The Bank is currently taking a "wait and see" approach to monetary policy. They are waiting to see the effect of the previous two hikes, the direction that NAFTA trade talks are going in (remember that 17% of Canada's GDP is linked to exports to the US) and other geopolitical developments and fiscal policies. Therefore despite data painting a positive economic picture we do not think the Bank of Canada will hike rates tomorrow (Wednesday) but expect them to continue their policy rate tightning cycle in the new year.

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