NATIONAL BANK OF CANADA
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BoC Policy Monitor

Economics and Strategy

May 24, 2017

Bank of Canada: A tightening bias on the horizon

As widely expected, the Bank of Canada left the overnight rate unchanged at 0.50% today. While the central bank acknowledged "robust" consumer spending and the housing sector, it bemoaned "subdued" export growth resulting from "ongoing competitiveness challenges". The BoC also made clear "the uncertainties outlined in the April MPR continue to cloud the global and Canadian outlooks". The fact that core inflation remains below 2% and wage growth is subdued is "consistent with ongoing excess capacity in the economy" according to the BoC. However, intense competition in the retail sector is also temporarily pushing down prices according to the central bank. The BoC also said that macroprudential and other policy measures have yet to have a substantial cooling effect on housing markets.

Bottom line:

The no change decision was widely expected. But the tone of the statement was much less dovish than anticipated. Indeed the Bank chose to put the emphasis on the improving global economy and the fact that Canada's adjustment to the oil shock is largely complete. Gone was the reference to "material" excess capacity in the economy — that was replaced by the phrase "ongoing excess capacity". The latter explains the decision to stand pat for now, but the changing language sets the stage for a move from a neutral stance to a tightening bias before year end. The reference to the lack of success (so far) of macro-prudential measures in cooling the housing market is very interesting. It suggests that, if the resale market does not soften, the central bank may decide to complement macro-prudential measures with rate hikes in an attempt at restraining the rampant housing market. All told, the statement today is consistent with our view that there's a more than 40% chance of a BoC rate hike before year end.

Paul-André Pinsonnault/Krishen Rangasamy

Here is the press release (sections highlighted by us):

May 24, 2017

The Bank of Canada is maintaining its target for the overnight rate at 1/2 per cent. The Bank Rate is correspondingly 3/4 per cent and the deposit rate is 1/4 per cent.

Inflation is broadly in line with the Bank's projection in its April Monetary Policy Report (MPR). Food prices continue to decline, mainly because of intense retail competition, pushing inflation temporarily lower. The Bank's three measures of core inflation remain below two per cent and wage growth is still subdued, consistent with ongoing excess capacity in the economy.

The global economy continues to gain traction and recent developments reinforce the Bank's view that growth will gradually strengthen and broaden over the projection horizon. As anticipated, growth in the United States during the first quarter was weak, reflecting mostly temporary factors. Recent data point to a rebound in the second quarter. The uncertainties outlined in the April MPR continue to cloud the global and Canadian outlooks.

The Canadian economy's adjustment to lower oil prices is largely complete and recent economic data have been encouraging, including indicators of business investment. Consumer spending and the housing sector continue to be robust on the back of an improving labour market, and these are becoming more broadly based across regions. Macroprudential and other policy measures, while contributing to more sustainable debt profiles, have yet to have a substantial cooling effect on housing markets. Meanwhile, export growth remains subdued, as anticipated in the April MPR, in the face of ongoing competitiveness challenges. The Bank's monitoring of the economic data suggests that very strong growth in the first quarter will be followed by some moderation in the second quarter.

All things considered, Governing Council judges that **the current degree of monetary stimulus is appropriate at present**, and maintains the target for the overnight rate at 1/2 per cent

Information note

The next scheduled date for announcing the overnight rate target is 12 July 2017. The next full update of the Bank's outlook for the economy and inflation, including risks to the projection, will be published in the MPR at the same time

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