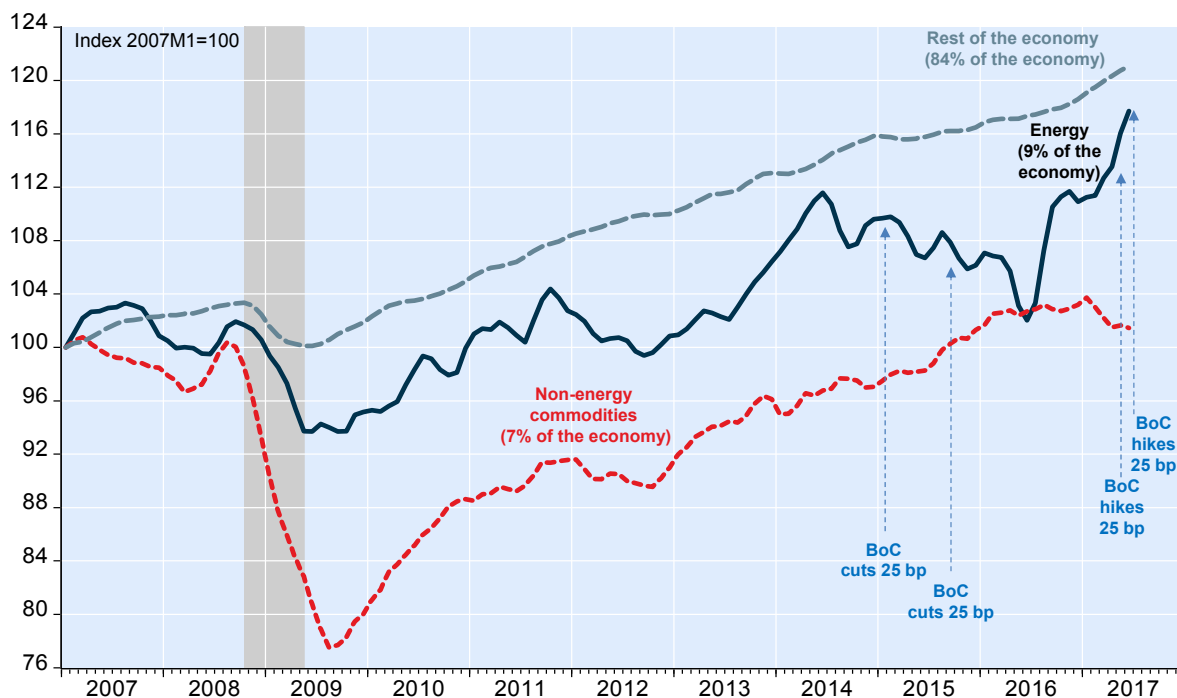


Strengthening economy prompts BoC to hike overnight rate again

The Bank of Canada raised the overnight rate by 25 basis points to 1.00% at today's meeting. The central bank supported its decision by pointing to solid growth in consumption, business investment and exports and said growth "is becoming more broadly-based and self-sustaining". The central bank, however, thought there is still some excess capacity in Canada's labour market, highlighting subdued wages and prices to prove its point. The BoC also acknowledged downside risks such as geopolitics and uncertainties with regards to trade and fiscal policy.

Canada: Improving economy warrants rate hikes

Real gross domestic product, constant 2007 dollars



NBF Economics and Strategy (data via Statistics Canada)

Bottom line:

A rate hike was always in the cards after the string of solid economic numbers and the Bank of Canada felt it did not have to wait until October's Monetary Policy Report to tighten policy further. In fact, the BoC's measure of the output gap is now closed after a blistering first half of the year. That sets the stage for another rate hike before year end. Recall that there is potential for cost-push inflation in light of Ontario's 23% increase in the minimum wage on January 1st 2018. Interestingly, the central bank mentioned the Canadian dollar's appreciation, but not in a negative way, saying instead that it reflected "the relative strength of Canada's economy". That suggests the loonie's strength is, at this point, not dissuading the central bank from tightening further. We are still calling for a rate hike in December, at which time more information will be available about the extent of fiscal stimulus both at the federal and provincial levels (e.g. pre-election spending in Ontario and Quebec).

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

September 6, 2017

The Bank of Canada is raising its target for **the overnight rate to 1 per cent**. The Bank Rate is correspondingly 1 1/4 per cent and the deposit rate is 3/4 per cent.

Recent economic data have been stronger than expected, supporting the Bank's view that **growth in Canada is becoming more broadly-based and self-sustaining**. Consumer spending remains robust, underpinned by continued solid employment and income growth. There has also been more widespread strength in business investment and in exports. Meanwhile, the housing sector appears to be cooling in some markets in response to recent changes in tax and housing finance policies. The Bank continues to expect a moderation in the pace of economic growth in the second half of 2017, for the reasons described in the July Monetary Policy Report (MPR), but the level of GDP is now higher than the Bank had expected.

The global economic expansion is becoming more synchronous, as anticipated in July, with stronger-than-expected indicators of growth, including higher industrial commodity prices. **However, significant geopolitical risks and uncertainties around international trade and fiscal policies remain**, leading to a weaker US dollar against many major currencies. **In this context, the Canadian dollar has appreciated, also reflecting the relative strength of Canada's economy.**

While inflation remains below the 2 per cent target, it has evolved largely as expected in July. There has been a slight increase in both total CPI and the Bank's core measures of inflation, consistent with the dissipating negative impact of temporary price shocks and the absorption of economic slack. Nonetheless, there remains some excess capacity in Canada's labour market, and wage and price pressures are still more subdued than historical relationships would suggest, as observed in some other advanced economies.

Given the stronger-than-expected economic performance, Governing Council judges that today's removal of some of the considerable monetary policy stimulus in place is warranted. Future monetary policy decisions are not predetermined and will be guided by incoming economic data and financial market developments as they inform the outlook for inflation. **Particular focus will be given to the evolution of the economy's potential, and to labour market conditions. Furthermore, given elevated household indebtedness, close attention will be paid to the sensitivity of the economy to higher interest rates.**

Information note

The next scheduled date for announcing the overnight rate target is October 25, 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.

BoC Policy Monitor

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