A more upbeat message from the BoC

By Krishen Rangasamy & Paul-André Pinsonnault

The Bank of Canada left the overnight rate unchanged at 1.75% today. While the central bank says ongoing trade conflicts and related uncertainty "remain the biggest source of risk to the outlook", it was encouraged by "nascent evidence that the global economy is stabilizing".

Looking at Canada’s economy, the central bank acknowledged investment was unexpectedly strong in Q3 and the fact that on-target inflation is “consistent with an economy operating near capacity”. The BoC says that solid wage growth is supporting consumer spending and housing investment continues to benefit from strong demographics and low mortgage rates. The central bank made clear that, in devising monetary policy, it will assess adverse impacts of trade conflicts on the Canadian economy. But it will also incorporate fiscal policy developments in January’s Monetary Policy Report.

Bottom line:

This morning’s statement from the Bank of Canada was arguably more upbeat than the message put out last October. Upward revisions to Canadian GDP were not directly mentioned by the central bank, although emphasis on “resilience” of the economy suggests the BoC is now more comfortable about the Canadian outlook. As such, unlike in October, the option of rate cuts were probably not on the table at this meeting. In addition to being forced to raise its 2019 GDP growth forecast for Canada (because of the better-than-expected handoff from 2018Q4), the central bank may also have to upgrade the 2020 outlook as it incorporates fiscal policy in January’s Monetary Policy Report. Of course, that assumes the global economic outlook does not deteriorate from here e.g. trade tensions intensify. All told, we remain comfortable with our forecast of a steady overnight rate over the near to medium term.

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

December 4, 2019

The Bank of Canada today maintained its target for the overnight rate at 1 ¾ percent. The Bank Rate is correspondingly 2 percent and the deposit rate is 1 ½ percent.

The Bank’s October projection for global economic growth appears to be intact. There is nascent evidence that the global economy is stabilizing, with growth still expected to edge higher over the next couple of years. Financial markets have been supported by central bank actions and waning recession concerns, while being buffeted by news on the trade front. Indeed, ongoing trade conflicts and related uncertainty are still weighing on global economic activity, and remain the biggest source of risk to the outlook. In this context, commodity prices and the Canadian dollar have remained relatively stable.

Growth in Canada slowed in the third quarter of 2019 to 1.3 percent, as expected. Consumer spending expanded moderately, underpinned by stronger wage growth. Housing investment was also a source of strength, supported by population growth and low mortgage rates. The Bank continues to monitor the evolution of financial vulnerabilities related to the household sector. As expected, exports contracted, driven by non-energy commodities. However, investment spending unexpectedly showed strong growth, notably in transportation equipment and engineering projects. The Bank will be assessing the extent to which this points to renewed momentum in investment.

CPI inflation in Canada remains at target, and measures of core inflation are around 2 percent, consistent with an economy operating near capacity. Inflation will increase temporarily in the coming months due to year-over-year movements in gasoline prices. The Bank continues to expect inflation to track close to the 2 percent target over the next two years.

Based on developments since October, Governing Council judges it appropriate to maintain the current level of the overnight rate target. Future interest rate decisions will be guided by the Bank’s continuing assessment of the adverse impact of trade conflicts against the sources of resilience in the Canadian economy – notably consumer spending and housing activity. Fiscal policy developments will also figure into the Bank’s updated outlook in January.

Information note:

The next scheduled date for announcing the overnight rate target is January 22, 2020. 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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