Bank of Canada Holds With A Hawkish Bias

Actual: 1.25%
Scotia: 1.25%
Consensus: 1.25%

- **The BoC left its policy rate unchanged at 1.25% with a hawkish bias as generally advised** in this morning's note and the Global Week Ahead. **Nothing in this statement reads that the BoC views its work as done for the year; indeed, much to the contrary as the BoC took a further step toward teeing up a July hike and *at least* one more thereafter this year.** The undervalued C$ appreciated by over one cent versus the USD and the GoC two year yield soared by 6bps post-statement. OIS market probabilities assign about an 80% probability to a hike on July 11th which is our call to be followed by one more this year in our house forecast.
- The overall statement was short and sweet. A formal statement comparison is of limited value for an off-MPR statement compared to a full forecast revision in the April statement but is nevertheless attached.
- There are several things to note, but two are key.
- The most important is that gone in this statement is the prior reference: "In this context, Governing Council will remain cautious with respect to future policy adjustments, guided by incoming data." By dropping "cautious" the BoC sent a hawkish signal to the markets. Recall that Poloz had previously offered the following interpretation of the word "cautious":

  "My interpretation of the word cautious is like it is in the English language, which is you are careful and you watch for signs you are making a mistake. It is not a code."

    - To drop 'cautious' therefore implies that the BoC has yet more confidence in its outlook and that it is not making a mistake by tightening monetary policy which is unambiguously more hawkish at the margin.
- The second most important element of the statement was at the end of paragraph 4:

  "Going forward, solid labour income growth supports the expectation that housing activity will pick up and consumption will continue to contribute importantly to growth in 2018."

    - **The strong signal here is that they're not worried enough about the household sector to halt rate moves.** That remains the right thing to do in my opinion.
- **The BoC is more encouraged by the US economy:** "Recent data point to some upside to the outlook for the US economy."
- The statement flags global trade policy and geopolitical risks in a somewhat altered fashion. The prior statement noted "However, escalating geopolitical and trade conflicts risk undermining the global expansion." The current statement escalates this somewhat by stating "At the same time, ongoing uncertainty about trade policies is dampening global business investment and stresses are developing in some emerging market economies." This is not new per se as the Governor has advised about investment risks previously.

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- The BoC acknowledges higher oil prices than assumed last month.
- **The BoC also acknowledges that growth in Q1 "appears to have been a little stronger than projected."** This is true so far since the BoC had forecast Q1 growth of just 1.3% q/q at a seasonally adjusted and annualized rate in Q1 within the April MPR and we're tracking closer to 1¾ - 2% (Scotia 1.9%). To repeat the caution in the Global Week Ahead, watch the potential for strong import gains to translate into inventory investment as an upside risk. The BoC also sounded encouraged by the composition of growth.
- **BoC Deputy Governor Sylvain Leduc delivers an "economic progress report" tomorrow at 12:50pmET.**
- Governor Poloz will be co-hosting the G7 meeting of finance ministers and central bank heads starting Thursday through Saturday. It will conclude with a press conference hosted by Finance Minister Morneau and Poloz on Saturday afternoon (exact time TBD).

RELEASE DATE: MAY 30, 2018

The Bank of Canada today maintained its target for the overnight rate at 1¼ per cent. The Bank Rate is correspondingly 1½ per cent and the deposit rate is 1 per cent.

Global economic activity remains broadly on track with the Bank's April *Monetary Policy Report (MPR)* forecast. ***Recent data point to some upside to the outlook for the US economy. At the same time, ongoing uncertainty about trade policies is dampening global business investment and stresses are developing in some emerging market economies. Global oil prices have been higher than assumed in April, in part reflecting geopolitical developments.***

Inflation in Canada has been close to the 2 per cent target and will likely be ***a bit higher in the near term*** than forecast in April, largely because of recent increases in gasoline prices. Core measures of inflation remain near 2 per cent, consistent with an economy operating close to potential. ***As usual, the Bank will look through the transitory impact of fluctuations in gasoline prices.***

In Canada, economic data since the April *MPR* have, on balance, supported the Bank's outlook for growth around 2 per cent in the first half of 2018. ***Activity in the first quarter appears to have been a little stronger than projected.*** Exports of goods were more robust than forecast, and data on imports of machinery and equipment suggest continued recovery in investment. Housing resale activity has remained soft into the second quarter, as the housing market continues to adjust to new mortgage guidelines and higher borrowing rates. ***Going forward, solid labour income growth supports the expectation that housing activity will pick up and consumption will continue to contribute importantly to growth in 2018.***

Overall, developments since April further reinforce Governing Council's view that higher interest rates will be warranted to keep inflation near target. Governing Council will take a gradual approach to policy adjustments, guided by incoming data. In particular, the Bank will continue to assess the economy's sensitivity to interest rate movements and the evolution of economic capacity.

RELEASE DATE: APRIL 18, 2018

The Bank of Canada today maintained its target for the overnight rate at 1 ¼ per cent. The Bank Rate is correspondingly 1 ½ per cent and the deposit rate is 1 per cent.

Inflation in Canada is close to 2 per cent as temporary factors that have been weighing on inflation have largely dissipated, as expected. Consistent with an economy operating with little slack, core measures of inflation have continued to edge up and are all now close to 2 per cent. The transitory impact of higher gasoline prices and recent minimum wage increases will likely cause inflation in 2018 to be modestly higher than the Bank expected in its January *Monetary Policy Report* (MPR), returning to the 2 per cent target for the rest of the projection horizon.

The global economy is on a modestly stronger track than forecast in January, with upward revisions to growth and potential output in a number of major advanced economies. The outlook for the U.S. economy has been further boosted by new government spending plans. However, escalating geopolitical and trade conflicts risk undermining the global expansion.

In Canada, GDP growth in the first quarter was weaker than the Bank had expected, but should rebound in the second quarter, resulting in 2 per cent average growth in the first half of 2018. The economy is projected to operate slightly above its potential over the next three years, with real GDP growth of about 2 per cent in both 2018 and 2019, and 1.8 per cent in 2020. This stronger profile for GDP incorporates new provincial and federal fiscal measures announced since January. It also reflects upward revisions to estimates of potential output growth, which suggest the Canadian economy has made some progress in building capacity.

Slower economic growth in the first quarter primarily reflects weakness in two areas. Housing markets responded to new mortgage guidelines and other policy measures by pulling forward transactions to late 2017. Exports also faltered, partly owing to transportation bottlenecks. Some of the weakness in housing and exports is expected to be unwound as 2018 progresses.

The Bank anticipates that Canadian exports will strengthen as foreign demand increases, but not sufficiently to recover the ground lost during recent quarters. Export growth is being increasingly limited by capacity constraints in some sectors. Continued gains in business investment should build additional capacity in those sectors and in the economy more generally. However, both exports and investment are being held back by ongoing competitiveness challenges and uncertainty about trade policies.

Growth in consumption remains robust, supported by strong labour income growth. Wages have continued to pick up as expected, even after factoring out recent minimum wage increases in Ontario and Alberta. The Bank will continue to assess labour market data for signs of remaining slack.

Some progress has been made on the key issues being watched closely by Governing Council, particularly the dynamics of inflation and wage growth. This progress reinforces Governing Council's view that higher interest rates will be warranted over time, although some monetary policy accommodation will still be needed to keep inflation on target. The Bank will also continue to monitor the economy's sensitivity to interest rate movements and the evolution of economic capacity. ***In this context, Governing Council will remain cautious with respect to future policy adjustments, guided by incoming data.***