Bank of Canada Rate Announcement

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As widely anticipated, the Bank of Canada raised its policy rate to 1.75 per cent on Wednesday, while maintaining expectations for further hikes in the quarters ahead.

In its communique, the Bank noted positives such as robust U.S. economic growth, improved expectations for business investment following the US-Mexico-Canada Agreement, and the LNG project in B.C. On the downside, U.S.-China trade conflicts are weighing on global growth, which could further transmit into Canada's growth profile. Canadian household demand is expected to hold up as employment income rises and population growth remains elevated, despite the housing market slowdown.

Inflationary pressures have been volatile due to temporary factors like airfares and gasoline prices, as well as methodological changes, but core measures are steady near the Bank's target of two per cent suggesting an economy near capacity. In a clear message of interest rate trend, it noted that the "Governing Council agrees that the policy interest rate will need to rise to a neutral stance to achieve the inflation target". The Bank estimates the neutral rate at between 2.5 to 3.5 per cent, the only question is pace of getting there assuming no serious disruption from the forecast.

In addition to the communique, the Bank published the accompanying Monetary Policy Report. Some of the highlights are as follows:

- Broad economic growth is solid, with the Bank's world growth forecast virtually unchanged from the previous report. Growth is forecast at 3.8 per cent this year, followed by 3.4 and 3.4 per cent in 2019 and 2020. The U.S. – China tariff war, and other protectionist measure are dragging on global output (up to 0.3 per cent through 2020, but with upside and downside uncertainty). Emerging markets are under pressure with U.S. denominated debt and financial stress in Argentina, Turkey, and others.
- The Bank forecasts Canada's growth at 2.0 per cent this year, 2.1 per cent in 2019, and 1.9 per cent in 2020. Growth for 2018 was revised slightly higher by 0.1 pp, with 2019 lower by the same magnitude. Steady consumer demand is forecast with growth of 1.2 per cent in 2019 and 1.1 per cent in 2020. Households have adjusted to higher interest rates and housing policy changes and a mild recovery is expected by the Bank, including a pick up in housing starts, which we question.
- USMCA is positive for growth through export and investment channels, both of which were revised higher, but lower commodity prices are a drag.
- Canada's economy continues to operate near capacity, with the Bank estimating the output gap at -0.5 to +0.5 per cent. The Business Outlook Survey points to capacity pressures and labour shortages, although wage growth was moderate at near 2.3 per cent in Q2. Growth is expected to remain near potential
- Households have adjusted to new housing policies, curtailing home sales which is now recovering. The Bank points to higher quality loans. Credit growth has slowed sharply. The sharpest decline in the number of new mortgages were those with high loan-to-income ratios.
- Business investment should receive a lift from a liquefied natural gas investment in B.C., M&E investments to meet demand and general increase in capacity.

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