Bank of Canada Rate Announcement

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The Bank of Canada kept its target for the overnight rate unchanged at 1.75 per cent. The Bank indicated that it will wait until there is a clearer view of where the economy is headed given the mixed data flow and uncertainty over trade disputes. The main takeaway is no change in rates in the near term, and the future path in rates is data and policy dependent.

Market reaction to the announcement was a weaker Canadian dollar and lower bond yields.

The weak Canadian economy and the global slow-down were the main reasons for maintaining policy rates at current levels. Canada's economy expanded 0.4 per cent in the fourth quarter of 2018 compared to the Bank's 1.3 per cent forecast. The Bank saw more forecast disappointment and below-potential growth in the first half of 2019.

The Bank will release a forecast update at its next meeting in April, and indications point to a downgrade to its 2019 forecast of 1.7 per cent growth. Even with firmer growth in the second half of 2019, growth for the year will likely come in closer to 1.5 per cent. The Bank was forecasting 2.1 per cent growth in 2020 led by gains in housing, business investment, and government spending. However, this forecast may well be upgraded relative to its new, and likely lower, potential growth estimate. This will result in a closing of the output gap and slack in the economy, setting the stage for a resumption of rate normalization. The Bank is uncomfortable with rates below its neutral range.

The Bank cited increased uncertainty about the timing of future rate increases and showed its rate bias by not acknowledging the possibility of rate decreases. A neutral statement would include wording such as uncertainty over the direction of future rates. A rate cut could occur if U.S.-China trade talks breakdown or if the U.S. imposes auto tariffs, which would depress global growth further and send markets lower. Another rate cut scenario is more under performance in Canada's housing and business investment. Futures markets are pricing in about a 20 per cent chance of a rate cut following this announcement.

No rate change is expected for most of 2019, if not through the year. There is a fair chance that global growth will improve in the second half of 2019 with policy stimulus measures in China, a framework trade deal between the U.S. and China, no auto tariffs, and the unwinding of some temporary factors present in 2018. A flat rate outlook in 2020 is likely with about a 25 per cent chance of a rate increase and 15 per cent for a rate cut.

Helmut Pastrick
Chief Economist, Central 1 Credit Union
hpastrick@central1.com
www.central1.com 604.737.5026