April 12, 2017

TD Economics

Data Release: Still waiting for Sunny Stephen

- The Bank of Canada elected to hold its key monetary policy interest rate unchanged at 0.50% despite an upgraded near-term economic outlook.
- Today's updated forecasts are for economic growth of 2.6% this year (January forecast: 2.1%). The outlook for 2018 was downgraded slightly, to 1.9% (from 2.1%). The Bank also provided its first forecast of 2019 GDP growth, which sees a 1.8% expansion. Consistent with the revised forecasts (and a downgraded estimate of potential growth), the Bank of Canada now expects the output gap to close in the first half of 2018, slightly earlier than previously thought.
- Despite the revisions to the outlook, the statement accompanying the interest rate decision struck a somber tone. Canada is seen has having 'material slack', and while the positive tone in the recent data was acknowledged, the statement pointed to soft hours worked, uneven export growth, and the challenges related to business investment. Perhaps the clearest indication of the Bank's thinking was the statement that "it is too early to conclude that the economy is on a sustainable growth path"
- On the inflation front, there were no significant changes in view, with weak core inflation highlighted, but headline inflation forecasted to trend near the 2% target through most of the projection.
- The expected drivers of growth this year have been tweaked: housing is now expected to contribute positively to growth, while the government spending profile has been spread out somewhat, reflecting delays in infrastructure projects. Net trade has been upgraded, although seemingly at the expense of later years.
- Four main risks to the inflation outlook were provided. Stronger U.S. growth remains a key upside risk for the Canadian economy, alongside stronger, but debt-fueled household spending (which itself creates a longer-term downside risk). Sluggish business investment and the possibility of stronger than estimated potential growth are seen as the main downside risks (to inflation).

Key Implications

- The growth outlook may be sunnier, but it seems to be all about the negatives for Governor Poloz. The statement accompanying today's decision attempted to throw cold water on discussions of the recent improvement in Canadian economic indicators. Despite a generally improved forecast, Poloz remains focused on the soft spots in Canadian labour markets and exports, and is not yet ready to declare Canada 'out of the woods' when it comes to unevenness in economic growth.
- For the moment, softness in wage and hours worked data, and the current pace of core inflation, appear to support Poloz's cautious approach. That said, there is no denying that the near-term growth outlook has improved, as acknowledged by the Bank of Canada's improved forecast and statement that the output gap will close by early 2018 (previously:"mid-2018"). As economic slack continues to be absorbed, inflationary pressures are likely to mount and make it increasingly difficult to maintain a dovish tone.
- That is not to say that a hike is imminent, but rather that the calculus has begun to shift. The Bank of Canada clearly has no intention of following the Federal Reserve's path of interest rate increases (nor should they). Rather, the shifting balance of risks around inflation, particularly as we move into 2018 suggest the potential for a 'pulling forward' of the first rate hike.

Note that there will be a press conference at 11:15AM EST which may provide further insight into Governor Poloz's thinking.

Brian DePratto, Senior Economist
416-944-5069

@TD_Economics