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TD Economics

Data Release: Bank of Canada stays the course after second quarter blip

- As expected, the Bank of Canada kept its key policy interest rate unchanged at 0.5% today. The Bank continues to expect healthy economic growth in the second half of the year as the economy bounces back from the second quarter setback.
- The Bank appears increasingly concerned with the global growth backdrop, in particular the U.S. outlook. Highlighting the weaker-than-expected second quarter performance, the Bank sees a less certain outlook for U.S. business investment.
- Concerns were also raised regarding the Canadian outlook. Second quarter exports were characterized as weaker than expected, even taking the plethora of special factors that affected the data into account. While the same special factors and infrastructure activity are expected to boost growth in the second half of the year, the Bank nevertheless noted that "the ground lost over previous months raises the possibility that the profile for economic activity will be somewhat lower than anticipated in July."
- Financial vulnerabilities are seen as elevated and rising, despite preliminary signs of 'possible moderation in the Vancouver housing market'.
- While inflation remains roughly in line with the Bank of Canada's expectations, the balance of risks around the inflation profile are seen as tilted to the downside relative to previous expectations.

Key Implications

- Despite what looks to be a healthy momentum heading into the third quarter, the Bank of Canada struck a dovish tone in today's statements. Particular focus was given to developments in the U.S., where weak business investment has called the export recovery narrative into question, healthy July data notwithstanding. Interestingly, despite providing a laundry list of reasons to expect healthy growth in the second half of the year, the discussion of the Canadian growth outlook ended on the somewhat sour note that growth may disappoint their July forecast for growth of 3.5% and 2.8% q/q annualized in Q3 and Q4 respectively.
- We view the downside risk to the Bank's outlook as highly probable, and expect growth to average closer to 2.5% through these quarters – still sufficiently healthy to begin absorbing the economic slack that has developed since 2015 and maintain core inflation near the Bank's 2% target.
- The dovish tone from the Bank of Canada will likely have market participants re-examining the possibility of an interest rate cut. We remain of the view that absent material disappointment in exports, further easing is unlikely. The more likely scenario is a continued dovish tone from the Bank of Canada, reinforcing that the policy rate is not likely to be moved in the foreseeable future. Consistent with this, our forecast calls for the Bank of Canada to remain on hold throughout 2017 and 2018.

Brian DePratto, Economist
416-944-5069

@TD_Economics