TD Economics

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Data Release: Bank of Canada holds policy rate unchanged in face of weaker growth outlook

- The Bank of Canada left its key policy rate unchanged at 0.5% today, despite a weaker economic outlook relative to their October projections.
- Growth for 2016 is now forecast to be just 1.4%, 0.6% lower than anticipated in the previous Monetary Policy Report (MPR). The Bank continues to see a marked acceleration in growth in 2017, to 2.4%.
- Much of the near-term weakness is attributed to lower commodity prices and temporary factors, while the Bank also reiterated that "The declines in Canada's terms of trade and in the value of the Canadian dollar over the past year and a half have set in motion complex adjustments".
- The Bank sees overall inflation as returning to near target by the end of 2017, and re-stated its view that absent exchange rate moves, core inflation would be closer to 1.5%, rather than the actual 2.0% pace. Of note, in a break from past MPRs, inflation is forecast to reach 1.9% by the end of the forecast, rather than reaching the 2.0% target.
- In line with a weakened near-term outlook, and the absence of additional monetary stimulus, the Bank of Canada expects that economic slack will be eliminated only at the end of 2017, rather than mid-2017 (as expected in the October MPR).

Key Implications

- All eyes were on the Bank of Canada this morning ahead of a decision that could have easily gone in either direction. The Bank held the line in spite of a weaker overall growth outlook alongside an unchanged view on potential output and an inflation profile that does not see a return to target within the Bank's forecast horizon.
- In many ways, today's decision signals that the Bank of Canada has set the bar higher in terms of additional monetary policy response. With a significantly downgraded near-term outlook that is now largely in line with our own, it is clear that a marked downturn in economic activity would likely be necessary to prompt the Bank of Canada into action.
- The bank sees much of the near term weakness as temporary, and indeed temporary production shutdowns and other issues in the oil and gas sector have had a significant effect on overall output. Exports remained a focus in today's report, which highlighted several key sectors that have seen significant growth in the recent period, such as fish and shellfish products (0.5% of non-energy exports); packaging materials (0.7%); and medium and heavy trucks and buses (0.9%), among others.
- It should be noted that the Bank of Canada has not yet incorporated any potential fiscal stimulus. Our analysis suggests that stimulus consistent with Liberal election platform would boost growth in 2016 and 2017 by as much as 0.1 and 0.3 percentage points. This would help close the output gap more quickly, and help bring inflation back in line with the Bank's mandate.

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