As communicated in Governor Poloz's speech last week, the Bank of Canada held the overnight rate at 0.75% today. The Bank of Canada now sees the risks around the inflation profile as being more balanced, and financial stability risks evolving in line with their expectations. The result is that the current level of interest rates are deemed appropriately stimulative.

Growth, both within Canada and globally, is seen as progressing in line with the Bank's forecast. Canadian Q4 GDP was in line with the January Monetary Policy Report, while crude oil prices are close to the levels assumed in the Bank's last projection. The Bank continued to highlight the United States as being the main source of momentum globally.

Regarding the outlook for growth, the Bank of Canada reiterated its view that most of impact of the oil price shock will be felt in the first half of 2015, and potentially even more concentrated towards Q1. It is expected that a rotation in growth towards non-energy exports and investment, supported by the recent easing in financial conditions, will continue.

Key Implications

Following the surprise January interest rate cut, markets have been closely monitoring Bank of Canada communications. Today's decision to maintain the overnight rate at 0.75% is consistent with Governor Poloz's statement that the January cut bought the Bank some time to see how the economy responds.

There are two main themes in Canadian inflation at present. First, headline consumer prices are expected to decline outright in the second quarter of this year, due in large part to the drop in energy prices. In contrast, core inflation, the Bank of Canada's operational guide, is expect to remain near the 2% target through the forecast horizon, helped in part by the low level of the Canadian dollar. Core inflation appears unlikely to deviate meaningfully from the Bank of Canada's inflation target, which, combined with the additional (if modest) stimulus provided by the January cut, removes some of the impetus for an additional rate cut. In addition, oil prices have stabilized somewhat, and are expected to gradually recover over the next few years. As a result, we expect that the Bank of Canada will remain on hold until late next year, at which point it will begin to increase the policy rate.

That said, the Bank of Canada's move towards a risk-management framework for setting monetary policy appears to have brought with it an increased dependence on data. Although Governor Poloz communicated today's decision reasonably clearly, prior communication, such as a speech by Senior Deputy Governor Carolyn Wilkins, had a much more dovish tone. We will continue to carefully monitor Bank communication for a change in stance.

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