Data Release: Bank of Canada's Lane Explains the Economic Impacts of Lower Oil Prices

- Today's speech by Bank of Canada Deputy Governor Timothy Lane, entitled “Drilling Down – Understanding Oil Prices and Their Economic Impact”, laid out the Bank’s thinking on the causes and implications of falling oil prices on the global and Canadian economies.
- On the causes, the Mr. Lane put most of the weight on the sharp increase in supply having dramatically outpaced modestly weaker global demand. Invoking the ‘Hog Cycle’, Mr. Lane pointed to short- and medium-term imbalances in global demand and supply of oil leading to, at times, dramatic swings in prices. Accordingly, this is one of those times.
- Looking to the implications for the global economy, Mr. Lane spoke to the mitigating impact of lower oil prices. If caused by excess supply, lower oil prices benefit consumers and energy-intensive sectors. If caused by a lack of demand, it provides relief when it’s needed most.
- While beneficial to the global economy, the Bank of Canada estimates that overall, lower oil prices on the whole are negative for the Canadian economy. While weighing on real economic growth, the larger impact is to incomes through the terms of trade (relative export and import prices). This negative impact is expected to outweigh the benefits to consumers of lower prices at the pumps.

Key Implications

- All in all, today's speech by Deputy Governor Lane was intended to reassure central bank watchers that the Bank of Canada has the situation under control. As such, Mr. Lane made clear that the Bank intends to look through the impending decline in total CPI inflation, as it is considered to be temporary, while closely monitoring the impact of lower oil prices on the real economy, particularly the labour market.
- Consensus has generally formed around the first Bank of Canada interest rate hike taking place in the last quarter of 2015. However, the dovish tone taken in today's speech may pour some cold water on that. With Mr. Lane promising more details in the Bank of Canada's January 2015 Monetary Policy Report to be released next week, all indicators point to an interest rate hike coming later rather than sooner.

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