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TD Economics

Data Release: Poloz holds as uncertainty remains unabated

- Surprising no-one, Governor Poloz once again held the tiller steady, leaving the Bank of Canada's key policy interest rate unchanged at 0.50%.
- According to the Bank of Canada's latest projections Canadian GDP is now estimated to have expanded by 1.3% in 2016 (previously: 1.1%), and is expected to accelerate to 2.1% this year (was 2.0%). The Bank's projection of 2.1% growth in 2018 was left unchanged.
- The Bank remains concerned by global uncertainty, which it views as 'undiminished' – particularly as it relates to the United States, where the Bank has incorporated some preliminary assumptions around tax policies that it views will lead to slightly higher pace of U.S. economic growth. The statement that accompanied the rate decision continued to focus on the differences between the U.S. and Canada. Both the high level of slack in the Canadian economy and recent strength of the loonie were flagged as causes for concern.
- The Bank does not appear overly concerned about the currently slow pace of inflation (CPI-common: 1.3% year-on-year in November). Rising energy prices and the dissipation of food price impacts are expected to bring inflation close to the 2% target 'in the months ahead.'
- For 2017, the consumer is expected to remain the key driver of growth, with further help from a upwardly revised government sector, reflecting measures announced in the November Federal economic statement, as well as provincial government actions. Net trade is expected to be neutral for growth, while business investment and housing are expected to be modest drags on the economy.
- The Monetary Policy Report re-evaluated the risks to the outlook. Stronger U.S. growth and higher commodity prices remained as the upside risks. On the downside, weak household spending and slow Canadian business investment were joined by two new risks: a shift towards protectionist global trade policies, and higher global long-term interest rates.

Key Implications

- Beneath a 'steady as she goes' decision lies a great deal of concern for the Bank of Canada. First and foremost is the possibility of protectionist measures that would have a 'material' negative impact on Canada, although such measures have not been incorporated into the Bank's projections at this point. Also flagged for concern was the strength of the Canadian dollar, which is making ongoing competitiveness challenges worse. Finally, although the resource sector is seen as having largely adjusted to past commodity price movements, the aftershocks are seen as still reverberating in the Canadian economy.
- It was not all bad news in the report, as the consumer remains buoyant and both federal and provincial fiscal measures are expected to provide a solid base of support for the Canadian economy this year.
- Interestingly, despite the introduction of three new measures of core inflation, there was no discussion of either the new or old core inflation measures, nor was a forecast of any of them provided. The Bank of Canada has in the past referred to core inflation as the best predictor of future inflation.
- On balance, caution is once again the key to the Bank of Canada's thinking. Heightened uncertainty and the remaining economic slack both point to a Bank that is likely to maintain its policy rate at 0.50% for some time to come. As has been the case for some time, we view the risks around this outlook as tilted towards a cut. The expected contribution from stimulative Canadian fiscal policy seems high, particularly in light of the delays that have been observed in translating federal spending pledges into economic

activity on the ground. A further uptick in global yields that impacts Canada would not be welcome and may necessitate a reaction. Moreover, protectionist sentiment, even in the absence of actual measures, is likely to weigh on both exports and investment.

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

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