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TD Economics

Data Release: A hold and a more somber tone from the Bank of Canada

- The Bank of Canada met expectations, leaving its key policy interest rate unchanged at 0.50%. At the same time, the Bank again revised down its growth outlook, citing a weaker outlook for exports and the impact of recent government changes to mortgage markets.
- Economic growth is forecast to be just 1.1% this year (July forecast: 1.3%), picking up to a downwardly-revised 2.0% in 2017 (from 2.2%). The outlook for 2018 GDP growth was left unchanged at 2.1%.
- The largest revision to growth came out of housing, which is now expected to be a drag in 2017, subtracting 0.2 percentage points from economic growth (the previous forecast saw this sector adding 0.1 p.p. in 2017). The Bank of Canada estimates that the new measures to cool housing markets will subtract 0.3 percentage points from the level of GDP by the end of 2018 as resale activity slows and construction shifts to smaller units.
- Net exports were also revised down on the back of a softer outlook for U.S. business and residential investment. Offsetting this somewhat is an upward revision to consumption, supported by fiscal measures.
- A softer profile is seen for inflation, as the output gap has widened, and is now expected to close only around mid-2018, a half-year later than expected in July. As a result, core inflation has been revised down for both this year and next, and is not expected to return to target until 2018. In terms of headline inflation, the Bank sees recent weakness as temporary, and expects a return to 2% by the first quarter of 2017, trending close to, but slightly below target thereafter.
- The risks to the outlook were the same as in July: on the upside, stronger U.S. growth, higher oil prices, and on the downside, sluggish Canadian business investment, slower growth in EMEs, and weaker household spending. Interestingly, unlike July, where the downside risks were presented first, todays Monetary Policy Report placed the upside risks front and center.

Key Implications

- Caution remains the watchword for the Bank of Canada. The Bank focused on Canada's longer-term growth prospects, where external uncertainty and domestic policy changes both point to a softer growth outlook. The slightly dovish tone from the Bank of Canada this morning was consistent with this cautious approach.
- The Bank of Canada held interest rates steady today despite a weaker inflation and growth outlook. This is not surprising, as their hands are effectively tied right now. An interest rate hike is not likely any time soon, particularly given the Bank's dovish tone despite what remains a somewhat optimistic growth forecast (we expect GDP growth in 2017 of 1.8%, 0.2 percentage points lower than the Bank of Canada's updated forecast).
- On the other side of the coin, the continued rotation of economic growth depends on U.S. demand to drive exports. An interest rate cut would likely do little to nothing to spur exports, while potentially undoing much of the impact of recent housing market rule changes, spurring further financial stability risks. While the balance of risks remains skewed to the downside and thus towards a cut, the bar to further monetary easing remains high and Governor Poloz will likely be happy to sit on the sidelines for some time to come.

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