January 31, 2017

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Data Release: Poloz remains perturbed by the level of the loonie

- Bank of Canada Governor Stephen Poloz spoke today in Edmonton on the history and potential future of economic modelling at the Bank of Canada.
- The Governor's prepared remarks were an interesting telling of the development and use of economic models at the Bank of Canada, emphasizing that even as their models advance, there will remain a role for expert judgement in the decision making process.
- There were a few 'nuggets' regarding the near-term outlook for monetary policy within the speech, notably that the Bank is "well aware that the lingering aftermath of the crisis has left the Canadian economy with persistent excess capacity", and a reminder that "a large shock – or, perhaps, an accumulation of smaller shocks" can prompt monetary easing.
- More interesting were the Governor's responses in the question and answer session. The governor reiterated that the back-up in Canadian bond yields is "premature" given the slack remaining in the Canadian economy, and that the level of the Canadian dollar is a "headwind" to exports. The governor was also very clear that we should not expect the Bank of Canada to follow the Federal Reserve in setting monetary policy.

Key Implications

- What might have been an interesting if somewhat esoteric speech was livened up by audience questions. Poloz was careful in his choice of language, but nevertheless reinforced the messages he delivered with this month's Monetary Policy Report.
- The key message again was that higher rates are not warranted in Canada at this time, both in terms of longer-term borrowing costs, as well as monetary policy. The governor pointed once again to the differing stages of the business cycle and remaining economic slack in Canada as a key differentiator vis-à-vis the United States. The impacts, or likely impacts on the currency were also mentioned, as Poloz suggested that the recent broad-based strength of the loonie may not be justified.
- Ultimately, Poloz's messaging continues to reinforce the risk of further monetary easing in Canada. Statements regarding the lingering aftermath of the crisis and persistently low inflation (contrasted in the speech against a situation in which inflation is near target), as well as a reminder that the threshold to action can be breached either by a significant shock, or a series of small shocks both read as dovish. That said, the dovish tone reinforces the risk of an interest rate cut, but should likely not be seen as further increasing the risk. Rather, the remarks seem designed to temper market expectations about the future path of monetary policy.
- Indeed, we do not expect that further easing will be warranted given an outlook for steady absorption of the remaining economic slack, and near term economic growth that is likely to exceed the Bank of Canada's expectations. It does however remain the case that, as Governor Poloz would seem to be pointing out, the risks to the growth outlook remain tilted towards the downside, and hence towards further easing.

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