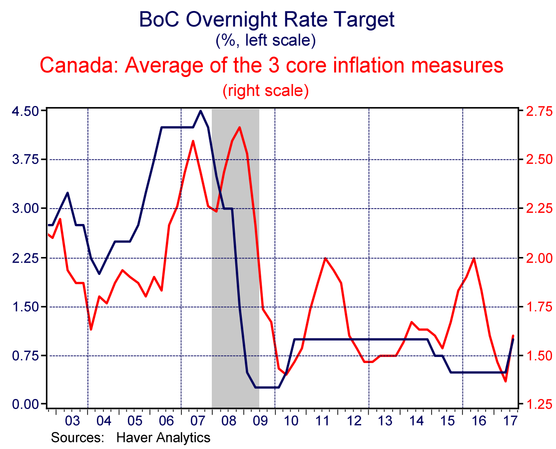
BoC Decision: Hitting the brakes



After increasing the overnight rate target by 25 basis points twice last summer, the BoC hit the brakes this fall. While the Canadian economic outlook is still uncertain due to uncertainty surrounding U.S. fiscal and trade policies, the BoC expressed a new concern: the possibility that inflation will fail to move higher as it used too even though the economy will eventually runs above full capacity. More particularly, the October *MPR* cites that new technologies, such as digitalization, are slightly weighting down on global CPI inflation. If the pace of technological changes continues to be fast, the world could be at the beginning of a structural shift that will boost productivity growth and potential GDP growth. This acknowledgement is a major turnaround. In its July *MPR*, the BoC attributed low inflation to temporary idiosyncratic factors, such as electricity rebates in Ontario.

Relative to its July *MPR*, the BoC also revised down its expectations for households spending. "*Housing and consumption are forecast to slow in light of policy changes affecting housing markets and higher interest rates. Because of high debt levels, household spending is likely more sensitive to interest rates than in the past*." The BoC also estimates that the new B-20 guidelines, recently announced by OSFI, will subtract about 0.2pp from real GDP in the next two years. The BoC also expressed concerns relative to the slack in the job market and slow wage growth. Labour market conditions might not be as tight as the 6.2% unemployment rate figure is suggesting. Lastly, the profile for exports has been revised down as well "*because of the stronger-than-expected Canadian dollar assumed in July*".

Altogether, the pace of growth in Canada's real GDP is projected to be cut by half overtime (from 3.1% this year to, 2.1% in 2018 and 1.5% in 2019). Thus, the ability for our central bank to further raise its policy rate appears somewhat limited in our view. We have never been in the camp of those predicting 3 to 4 hikes in 2018 and still maintain that the Bank of Canada will remain prudent and accommodative. While today's statement was unambiguously dovish, the last paragraph of the statement indicates that BoC officials still intend to remove stimulus in the future. We do not put too much weight on this timid tightening bias since the downside risk related to NAFTA renegotiations is not part of the BoC's base-case scenario. At best, we can see the BoC raising its policy rate once by 25 basis points in early 2018. Our year-end 2018 forecast for the overnight rate target is still 1.25%.

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