



Laurentian Bank Securities **ECONOMIC RESEARCH AND STRATEGY**

Bank of Canada Decision – Soft Hawkish Tilt despite Lots of Moving Parts

The Bank of Canada (BoC) left its overnight rate unchanged at 0.50%, as unanimously expected by markets participants. Today's statement includes slightly more upbeat than downbeat comments.

For instance, the BoC now states that *"the Canadian economy's adjustment to lower oil prices is largely complete"*. In turn, the gradual rebound in crude oil prices implies a pace of economic growth *"more broadly based across regions"*, another upbeat comment included in the statement. Despite improving labour market conditions and stronger household spending growth, Canada's overall inflation picture remains tame. The Bank's three measures of core inflation averaged 1.4% in April, a four-year low. Total CPI inflation was also below the 2% target at 1.6% during April: *"Food prices continue to decline, mainly because of intense retail competition, pushing inflation temporarily lower"*.

Despite the recent signs of broad based strength in the Canadian economy and less unused capacity, the BoC is still in an unsuitable position to sound significantly more hawkish given that a rise in U.S. protectionism still cloud the outlook. After the softwood lumber industry and the dairy supply management, the aerospace industry is now involved in trade protectionist talks. In addition, the much-needed sustainability of the Canadian economic recovery is contingent on soon-to-be-adopted U.S. fiscal policies. Among the other key risks highlighted in the April *Monetary Policy Report*, today's news that OPEC is close to an agreement to extent oil-supply cuts is constructive for the Canadian outlook.

There are also domestic-based risks to the outlook. One key unknown is the magnitude of the adjustment in the housing sector: *"Macroprudential and other policy measures, while contributing to more sustainable debt profiles, have yet to have a substantial cooling effect on housing markets"*. Indeed, national resale transactions hold near record high. Housing starts also increased in recent months. In addition, the new measures announced by the Ontario government quickly reduced the number of resale transactions in the GTA in April. But the firm rebound in sales and prices recently observed in Vancouver suggests the impact of such targeted housing policies could be short-lived. Also, speculative investment activities could increase into smaller housing markets such as Montreal. Finally, the BoC did not include in its statement a remark relative to the recent liquidity challenges at Home Capital Group. The BoC is more likely to address this issue in its assessment of risks in the June edition of the *Financial System Review*.

In summary, we were somewhat surprised to see that today's statement included some signs of a soft hawkish tilt. Until most of the considerable uncertainty clouding the outlook is removed, it is difficult for us to see if the BoC will be able to hike in the medium term. Thus, we continue to forecast the overnight rate target to end 2017, and more likely 2018, at 0.50%.

Sébastien Lavoie | Chief Economist

514 350-2931 | lavoies@vmbi.ca

This document is intended only to convey information. It is not to be construed as an investment guide or as an offer or solicitation of an offer to buy or sell any of the securities mentioned in it. The author is an employee of Laurentian Bank Securities (LBS), a wholly owned subsidiary of the Laurentian Bank of Canada. The author has taken all usual and reasonable precautions to determine that the information contained in this document has been obtained from sources believed to be reliable and that the procedures used to summarize and analyze it are based on accepted practices and principles. However, the market forces underlying investment value are subject to evolve suddenly and dramatically. Consequently, neither the author nor LBS can make any warranty as to the accuracy or completeness of information, analysis or views contained in this document or their usefulness or suitability in any particular circumstance. You should not make any investment or undertake any portfolio assessment or other transaction on the basis of this document, but should first consult your Investment Advisor, who can assess the relevant factors of any proposed investment or transaction. LBS and the author accept no liability of whatsoever kind for any damages incurred as a result of the use of this document or of its contents in contravention of this notice. This report, the information, opinions or conclusions, in whole or in part, may not be reproduced, distributed, published or referred to in any manner whatsoever without in each case the prior express written consent of Laurentian Bank Securities.



LAURENTIAN BANK
SECURITIES