Laurentian Bank Securities
ECONOMIC RESEARCH AND STRATEGY

Bank of Canada Decision (May 2019)
Encouraging signs for the Canadian economy but trade tensions worsen

The Bank of Canada (BoC) left its overnight rate target unchanged at 1.75% this morning.

Investors considering the idea of a policy rate cut should reconsider their position. The short 338 words statement begins with several positive remarks about the domestic economic momentum. For instance, the Canadian oil sector, housing activity, business investment and consumer spending have been gaining traction. Furthermore, the BoC acknowledged the improving prospects for exports following the recent removal of steel and aluminum tariffs. Altogether, these positive developments reinforced the BoC's view that the soft patch of economic growth observed in late 2018 and early 2019 was temporary.

This being said, the BoC could not move away from its current neutral bias due to the US-China trade spat: "*the recent escalation of trade conflicts is heightening uncertainty about economic prospects". A* possible Trump-Xi meeting later in June may bring clarity to the outlook. For instance, a partial trade agreement relative to merchandise exports/imports and the technological ban on Huawei, in exchange for fundamental commercial legislative changes in China, is in our view the most likely outcome at this point. While this is not a complete broad trade deal, we believe such an agreement could improve risk sentiment enough to bring back the tightening bias in the BoC statement during the second half of 2019. After all, the necessity to further reduce the vulnerability associated to elevated household debt requires higher interest rates. Moreover, the BoC specifies in today's statement that total and core measures of CPI inflation, already near 2%, are expected to stay close to the target in the near term.

Bottom Line: Today's statement slightly reinforces our view that the next move will eventually be a policy rate hike, although the encouraging signs observed recently relative to the Canadian economy still hang by a thread given the US-China trade conflict.

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