Bank of Canada: Reading Between the Lines

Sometimes what’s not said is as important as what is said, so Governor Poloz’s reluctance to cheer too loudly about Canada’s recent economic news is telling. It suggests that while its base case could be described as an all-clear outlook ahead, it’s becoming somewhat more concerned about an alternative scenario for the global economy that would impede our expansion.

Clearly, the Bank of Canada is in no hurry to adjust interest rates in either direction, leaving the policy rate unchanged today. In any projection accompanied a stand-pat decision on rates, the Bank will assert that monetary policy is currently “appropriate”, and the accompanying forecast will show an end point with on-target inflation and the economy growing close to potential. They indeed checked both those boxes today. While there’s a small output gap remaining in 2021, the small downward pressure on inflation it generates is seen as only offsetting carbon taxes to keep inflation at 2%.

But the Bank could have taken an even sunnier tone given the strong gains in both employment and GDP components in recent months. Instead, it chose to downplay some of the upside surprise we’ve seen in second quarter growth, by noting that some of it is due to “temporary” factors, and by inserting an offsetting downward adjustment to second half growth to minimize the impact on the overall 2019 pace.

As well, we always pay close attention to the topics the Bank of Canada chooses to address in the special “boxes” in its Monetary Policy Report, because these sections address subjects that it sees as timely and material to the outlook. Today’s MPR shined a spotlight on “risks associated with global trade policies” and concluded that the downside risks to Canada were larger than the potential upside should trade policies swing one way or another. While the Bank argues that a trade war would escalate inflation (from tariffs and less efficient global production chains), BoC policy has tended to look through one-off climbs in the price level and focus more on the impacts on economic slack.

A few months ago, Governor Poloz was willing to state that when it did come, the next move was more likely to be a hike than a cut. At today’s press conference, he talked about rates being appropriate, and that they would respond if headwinds dissipated or worsened; that’s a more nuanced statement that leaves room for a move in either direction.

Make no mistake, there’s no immediate pressure on the Bank of Canada to cut interest rates, even with the Fed signaling its intention to do so. In part, that reflects the simple fact that Governor Poloz raised rates more cautiously than his US counterparts, which now looks to have been a wise course. Unlike the chorus from the White House, Canada’s political leaders are not pressing for a rate cut, and markets aren’t in a hurry to price in such a development this year. The labour market has been pumping out jobs, albeit not necessarily in the highest paid sectors and without much pressure on wages.
But the Bank of Canada notes that lower bond yields have been helping the stabilization we’ve seen in housing, and to sustain that, short rates would at some point have to be lower. The forecast for growth ahead relies on companies choosing to expand in Canada to meet export demand. Standing pat on rates while others ease risks sending the currency to levels that would dampen exports.

We continue to look for a quarter point cut in 2020 as a means of countering that tendency, and to address the spillover from slower growth abroad. But it will be a while before that gets reflected in Bank of Canada language, which tends to shy away from providing forward guidance for a move that is quarters, not months, away.