Let’s give credit where credit is due. The Bank of Canada was smart to stop hiking a year ago when the Fed pressed on to still higher rates, has now finely judged the knife edge on which the economy now rests, and has set the stage for reacting on a timely basis should it start tipping over into an undesired further deceleration.

The evidence to date didn’t yet make an overwhelming case for cutting interest rates from today’s already low levels. But Canada’s central bank is clearly aware that no economy is an island unto itself, and sent a message to markets, particularly the foreign exchange market, that it is prepared to trim rates if the headwinds facing trade-oriented manufacturing and resource sectors deepen or spill over into the rest of the country. We see those headwinds as showing up more materially in the fourth quarter, setting the stage for a policy ease, albeit a lone quarter point cut, in January.

Right now, the Bank believes that current interest rates won’t set off a boom, but will still leave the economy with a good enough growth rate. Good enough to squeeze out the small gap that remains between GDP and its non-inflationary potential, and good enough to have inflation running near the 2% target. This year’s GDP outlook got bumped up due to the upside surprise in Q2 that owed to “temporary factors”, and was more than offset in the BoC forecast by a 0.2%-point haircut to growth in each of the next two years (to 1.7% and 1.8% respectively). While that would be a very acceptable outcome, the question is whether achieving it will require a policy ease.

Wage rates have improved to a 3% pace, lending support to consumers, mortgage rates eased enough to reinvigorate housing in most regions, and government spending is supportive, albeit with a mixed picture ahead given provincial fiscal restraint against some easing in a post-election federal fiscal stance.

But Governor Poloz and his team are not blind to the external risks ahead. They noted that the economy will be “increasingly tested” by global growth uncertainties and trade conflicts. The estimate of the damage to global growth from trade conflicts has increased, although given monetary policy offsets, that only subtracted a tick from the Bank of Canada’s world GDP projection for 2019 and 2020. The Bank opted to mention the climb in the Canadian dollar against non-US currencies, a hint to markets that it would be concerned if that trend continued and ate into trade competitiveness. Indeed, the potential for the loonie to appreciate if the Bank stands pat while others ease could be one motivation for a slight trimming in rates ahead, along with what we see as a likely slight downside miss versus the Bank of Canada’s 1.3% forecast for Q4 growth.

So why not cut rates today? For one, rates are still below the Bank of Canada’s estimates for long run neutrality, so in effect, they could argue that they have already been providing some stimulus to domestic demand. Inflation is not running below target, as it is elsewhere in countries that have eased interest rates. Moreover, there’s that little issue of household debt and financial stability.
That cuts two ways. Lower rates provide a cushion for those with existing debt burdens, and indeed the Bank of Canada devoted space in the MPR to an assessment of how households are doing on mortgage renewals, concluding that the rates on renewal are likely to decline on average. That’s the plus side of low rates, in that they reduce the near term risks of financial stress. At the same time, even with new mortgage rules providing a greater degree of protection against excesses, encouraging still more debt accumulation by cutting interest rates is something the Bank of Canada would like to avoid if the economy can stay close to full capacity without it.

A December rate cut can’t be ruled out, but the meeting is early in December, and likely before enough evidence will have accumulated on the pace of growth in the fourth quarter. We continue to favour January as the most likely date for a 25 basis point rate cut. This is still a central bank that will need some convincing that the Canadian economy is in need of a boost. As Governor Poloz summed it up at the press conference, they don’t yet see the downside risks to growth are big enough to justify lower rates today. The data will have to show that before they will move, but we at CIBC expect the data to point that way by the time the central bank produces its next forecast in January.

While cutting once, and only once, might seem like unnecessary fine tuning, it would be important in deterring a further appreciation of the Canadian dollar that eats into export growth. Remember that when rates are this low, small cuts are more meaningful in terms of their percentage impacts on a monthly mortgage bill. As for historical precedent, the Bank of Canada only eased a total of 50 basis points in response to the major dent in the outlook after oil price plunged in late 2015. So yes, this is a central bank that has been willing to buy a bit of insurance with a bit of interest rate relief when warranted.