

ESSENTIALS OF THE MONETARY POLICY



Bank of Canada (BoC)

Encouraged by the Economy's Performance, the BoC Begins Raising Rates

ACCORDING TO THE BOC

- ▶ The BoC is raising its target for the overnight rate to 0.75%.
- ▶ The global economy continues to strengthen and growth is broadening across countries and regions. However, elevated geopolitical uncertainty still clouds the global outlook, particularly for trade and investment.
- ▶ Canada's economy has been robust, fuelled by household spending. As a result, a significant amount of economic slack has been absorbed.
- ▶ The BoC forecasts real GDP growth of 2.8% in 2017, 2.0% in 2018 and 1.6% in 2019
- ▶ The output gap is now projected to close around the end of 2017, earlier than the BoC anticipated in its April *Monetary Policy Report*.
- ▶ The factors behind soft inflation appear to be mostly temporary. As these effects fade and excess capacity is absorbed, the BoC expects inflation to return to close to 2% by the middle of 2018.

COMMENTS

Today's decision hardly comes as a surprise, as it marks the culmination of the BoC's recent change of tone. The BoC retained a positive tone in its statement, upgrading the outlook for growth in consumer spending and in business investment. With real GDP growth expected to comfortably exceed potential output growth during the upcoming quarters, the BoC sees the economy returning to full capacity as early as the end of 2017. From this standpoint, it became increasingly untenable to keep the key rates as low as they have been for the last two years.

The BoC clearly recognizes that inflation remains low, a situation it expects will continue for some time. Nonetheless, it believes that the temporary factors affecting energy and motor vehicle prices play an important role in explaining this weakness. Excluding these factors, the BoC believes inflation would be 1.8%, very close to its target of 2.0%.

A hike in interest rates causes some concern, especially when household debt is extremely high. However, the BoC's officials want to be reassuring. During his press conference, Governor Stephen Poloz argued that the economy is in a position to withstand the rate increase. Recent job growth has been vigorous, and some indicators point to a rise in hourly wages. It also has to be said that, at 0.75%, the key rate is still very low. Yet the BoC acknowledges that household finances are more sensitive to interest rates than in the past, which argues for a very gradual normalization of its monetary policy.

IMPLICATIONS

It had become obvious that maintaining very low rates was incompatible with the vitality of the economy. As the outlook remains favourable, we believe that the BoC will proceed with an additional increase of 25 basis points in October, bringing the overnight rate to 1.00%. Normalization is expected to start again in 2018.

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NOTE TO READERS: The letters k, M and B are used in texts and tables to refer to thousands, millions and billions respectively.

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Schedule 2017 of Central Bank Meetings

Date	Central banks	Decision	Rate	Date	Central banks	Decision	Rate
January				July			
11	Bank of Brazil	-75 b.p.	13.00	4	Reserve Bank of Australia	s.q.	1.50
12	Bank of Korea	s.q.	1.25	4	Bank of Sweden	s.q.	-0.50
18	Bank of Canada	s.q.	0.50	12	Bank of Canada	+25 b.p.	0.75
19	European Central Bank	s.q.	0.00	12	Bank of Korea		
30	Bank of Japan	s.q.	-0.10	20	European Central Bank		
February				20	Bank of Japan		
1	Federal Reserve	s.q.	0.75	26	Bank of Brazil		
2	Bank of England	s.q.	0.25	26	Federal Reserve		
6	Reserve Bank of Australia	s.q.	1.50	August			
8	Reserve Bank of New Zealand	s.q.	1.75	1	Reserve Bank of Australia		
9	Bank of Mexico	+50 b.p.	6.25	3	Bank of England		
15	Bank of Sweden	s.q.	-0.50	9	Reserve Bank of New Zealand		
22	Bank of Korea	s.q.	1.25	10	Bank of Mexico		
22	Bank of Brazil	-75 b.p.	12.25	30	Bank of Korea		
March				September			
1	Bank of Canada	s.q.	0.50	5	Reserve Bank of Australia		
6	Reserve Bank of Australia	s.q.	1.50	6	Bank of Brazil		
9	European Central Bank	s.q.	0.00	6	Bank of Canada		
15	Federal Reserve	+25 b.p.	1.00	7	European Central Bank		
15	Bank of Japan	s.q.	-0.10	7	Bank of Sweden		
16	Bank of England	s.q.	0.25	14	Bank of England		
16	Bank of Norway	s.q.	0.50	14	Swiss National Bank		
16	Swiss National Bank	s.q.	-0.75	20	Federal Reserve		
22	Reserve Bank of New Zealand	s.q.	1.75	21	Bank of Norway		
30	Bank of Mexico	+25 b.p.	6.50	21	Bank of Japan		
April				27	Reserve Bank of New Zealand		
4	Reserve Bank of Australia	s.q.	1.50	28	Bank of Mexico		
12	Bank of Korea	s.q.	1.25	October			
12	Bank of Brazil	-100 b.p.	11.25	3	Reserve Bank of Australia		
12	Bank of Canada	s.q.	0.50	18	Bank of Korea		
27	European Central Bank	s.q.	0.00	25	Bank of Brazil		
27	Bank of Sweden	s.q.	-0.50	25	Bank of Canada		
27	Bank of Japan	s.q.	-0.10	26	European Central Bank		
May				26	Bank of Norway		
2	Reserve Bank of Australia	s.q.	1.50	26	Bank of Sweden		
3	Federal Reserve	s.q.	1.00	31	Bank of Japan		
4	Bank of Norway	s.q.	0.50	November			
10	Reserve Bank of New Zealand	s.q.	1.75	1	Federal Reserve		
11	Bank of England	s.q.	0.25	2	Bank of England		
18	Bank of Mexico	+25 b.p.	6.75	7	Reserve Bank of Australia		
24	Bank of Korea	s.q.	1.25	8	Reserve Bank of New Zealand		
24	Bank of Canada	s.q.	0.50	9	Bank of Mexico		
31	Bank of Brazil	-100 b.p.	10.25	29	Bank of Korea		
June				December			
6	Reserve Bank of Australia	s.q.	1.50	5	Reserve Bank of Australia		
8	European Central Bank	s.q.	0.00	6	Bank of Brazil		
14	Federal Reserve	+25 b.p.	1.25	6	Bank of Canada		
15	Bank of England	s.q.	0.25	13	Federal Reserve		
15	Swiss National Bank	s.q.	-0.75	14	European Central Bank		
16	Bank of Japan	s.q.	-0.10	14	Bank of England		
21	Reserve Bank of New Zealand	s.q.	1.75	14	Bank of Norway		
22	Bank of Norway	s.q.	0.50	14	Bank of Mexico		
22	Bank of Mexico	+25 b.p.	7.00	14	Swiss National Bank		
				20	Bank of Sweden		
				21	Bank of Japan		

NOTE: Certain banks may decide to change rates in-between the scheduled meetings. The abbreviations s.q. and b.p. correspond to status quo and basis points respectively.