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Bank of Canada Policy Announcement and Monetary Policy Report

BoC Hikes Despite Trade Fears

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The Bank of Canada hiked rates 25 bps to 1.50% this morning, as fully expected. The **tone of the statement** wasn't as dovish as the market expected, with the C$ rallying and bonds selling off. There was a little something for everyone in the statement, but **the Bank's bias to continue pushing rates higher (even if slowly) remained clear**. Worries about trade protectionism were prominent, but as Governor Poloz noted in his press conference two weeks ago, the Bank will not shape policy based on rhetoric. And, some likely labour market slack was highlighted as well after being left out of the May statement.

In the **Monetary Policy Report**, **GDP growth** was actually **revised a tick higher** in 2019 (2.2%) and 2020 (1.9%), despite the trade risks. The composition of growth is shifting as well, something policymakers have been waiting many years to see, with exports and investment picking up while housing and consumption decelerate. And, Q2 growth was revised up three ticks to 2.8%, though Q3 was introduced at 1.5% (both more or less in line with our calls). Notably, the Bank once again increased their negative adjustment to growth (for investment and exports) due to trade uncertainties and have now included the impact of US and Canadian tariffs. However, the positive impact from higher oil prices roughly fully offsets those negatives. The inflation projection for 2018Q4 was revised up a tick to 2.5%, but that should have no impact on broader thinking.

For those interested, the MPR has some interesting boxes on the impact of tariffs, and rising rates on mortgage holders.

A few key quotes from the policy statement…

"*Governing Council expects that higher interest rates will be warranted to keep inflation near target and will continue to take a gradual approach, guided by incoming data.*" **This really says it all about the BoC right now**. Assuming their projections are correct, interest rates look to move gradually higher. **That leaves the BoC, and the market, very much data dependent**

Bank of Canada's Base-Case Projections

	2018				2019				2020				Average		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	18	19	20
Real GDP (% chng : a.r.)															
Apr-18 MPR	1.3	2.5											2.0	2.1	1.8
Jul-18 MPR	**1.3**	**2.8**	**1.5**										**2.0**	**2.2**	**1.9**
BMO CM	1.3	2.4	1.5	2.2	1.8	1.7	1.7	1.6					1.9	1.8	
CPI Inflation (y/y % chng)															
Apr-18 MPR	2.1	2.3		2.4				2.1				2.1	2.3	2.1	2.1
Jul-18 MPR	**2.1**	**2.2**	**2.5**	**2.5**				**2.1**				**2.1**	**2.4**	**2.2**	**2.1**
BMO CM	2.1	2.3	2.3	2.1	1.9	2.1	2.2	2.1					2.2	2.1	

until/unless something changes on the trade front.

On trade worries…There's plenty here, and while the risks are clearly elevated, the last quote is likely the key to the BoC's thinking at the moment.

"*The possibility of more trade protectionism is the most important threat to global prospects*"

"*Business investment is growing in response to solid demand growth and capacity pressures, although trade tensions are weighing on investment in some sectors*."

The effect of **trade uncertainty** is "*now judged to be larger, given mounting trade tensions*."

With respect to the tariffs in place "*Although there will be difficult adjustments for some industries and their workers, the effect of these measures on Canadian growth and inflation is expected to be modest*." That's consistent with the general consensus, with fears of auto tariffs much more acute due to the more significant potential impact on the broader economy.

On growth… "*Canada's economy continues to operate close to its capacity and the composition of growth is shifting*."

"*Household spending is being dampened by higher interest rates and tighter mortgage lending guidelines. Recent data suggest housing markets are beginning to stabilize following a weak start to 2018. Meanwhile, exports are being buoyed by strong global demand and higher commodity prices. Business investment is growing in response to solid demand growth and capacity pressures, although trade tensions are weighing on investment in some sectors*." **The rotation of growth away from housing and consumption is something the BoC has been waiting for years to see**. While the wait appears to be over, protectionism is a risk to that process.

The other dovish bit… "*The Bank estimates that underlying wage growth is running at about 2.3 per cent, slower than would be expected in a labour market with no slack*." Along with trade worries, this suggests the Bank isn't in a rush to push rates higher again. The labour market slack theme was cut from the May statement, but the re-inserting it means **the BoC wants to see more improvement on this front**.

Key Takeaway: Despite hiking rates today, the BoC is in no rush to continue pushing rates higher given the uncertainties surrounding trade, lingering concerns about housing and household debt, and renewed belief that there's some labour market slack. Look for Governor Poloz to reiterate that policy is data dependent at the press conference, remaining non-committal as always. If the data evolve decently over the next few months, our call for the next hike to come in October is very reasonable, but that's a big if given the trade concerns.