

ESSENTIALS OF THE MONETARY POLICY

Bank of Canada (BoC) A Break From Monetary Tightening



ACCORDING TO THE BOC

- ▶ The target for the overnight rate stays at 1.00%.
- ▶ The BoC still expects global growth to average around 3.50% over 2017–2019. However, this outlook remains subject to substantial uncertainty about geopolitical developments and fiscal and trade policies, notably the renegotiation of the North American Free Trade Agreement (NAFTA).
- ▶ Canada's economic growth in the second quarter was stronger than expected, and was more broad-based across regions and sectors. Growth is expected to moderate to a more sustainable pace in the second half of 2017 and remain close to potential over the next two years, with real GDP expanding at 3.1% in 2017, 2.1% in 2018 and 1.5% in 2019.
- ▶ Excess capacity has declined more rapidly than expected, and the BoC now estimates the output gap to be between -0.5% and 0.5% in the third quarter.
- ▶ The BoC projects inflation will rise to 2% in the second half of 2018. This is a little later than anticipated in July because of the recent strength in the Canadian dollar.
- ▶ While less monetary policy stimulus will likely be required over time, Governing Council will be cautious in making future adjustments to the policy rate. In particular, the BoC will be guided by incoming data to assess the sensitivity of the economy to interest rates, the evolution of economic capacity, and the dynamics of both wage growth and inflation.

COMMENTS

After tremendous growth between Q3 2016 and Q2 2017, the latest economic indicators suggest that the Canadian economy has slowed recently. However, this slowdown is nothing to worry about. All indications are that we are moving from a pace that is

unsustainable in the medium term to healthier growth of around 2% for the coming quarters.

This pace is still above the Canadian economy's growth potential, which is expected to be about 1.3% for 2017 and close to 1.4% in 2018, according to BoC estimates. Production capacity should therefore be in increasing demand, which could potentially translate into more significant upward pressure on prices, although there is still a great deal of uncertainty in that regard. In light of these circumstances, monetary tightening is expected to continue in the coming quarters.

However, the moderation in economic growth reduces the urgency of raising key interest rates. It is therefore appropriate for the BoC to be taking a break from its monetary tightening in October after increasing the target for the overnight rate twice in a row since July.

IMPLICATIONS

At 1.00%, the target for the overnight rate is still historically very low and is reflective of highly expansionary monetary policy. Normalization of key interest rates is therefore expected to continue in the coming quarters, but at a gradual pace. A third increase could be announced either in December or, more likely, in early 2018.

François Dupuis, Vice-President and Chief Economist
Benoit P. Durocher, Senior Economist

François Dupuis, Vice-President and Chief Economist

Mathieu D'Anjou, Senior Economist • Benoit P. Durocher, Senior Economist • Jimmy Jean, Senior Economist • Hendrix Vachon, Senior Economist

Desjardins, Economic Studies: 514-281-2336 or 1 866-866-7000, ext. 5552336 • desjardins.economics@desjardins.com • desjardins.com/economics

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 Korea	s.q.	1.25
19	European Central Bank	s.q.	0.00	12	Bank of Canada	+25 b.p.	0.75
30	Bank of Japan	s.q.	-0.10	19	Bank of Japan	s.q.	-0.10
February				20	European Central Bank	s.q.	0.00
1	Federal Reserve	s.q.	0.75	26	Federal Reserve	s.q.	1.25
2	Bank of England	s.q.	0.25	26	Bank of Brazil	-100 b.p.	9.25
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	s.q.	1.50
9	Bank of Mexico	+50 b.p.	6.25	3	Bank of England	s.q.	0.25
15	Bank of Sweden	s.q.	-0.50	9	Reserve Bank of New Zealand	s.q.	1.75
22	Bank of Korea	s.q.	1.25	10	Bank of Mexico	s.q.	7.00
22	Bank of Brazil	-75 b.p.	12.25	30	Bank of Korea	s.q.	1.25
March				September			
1	Bank of Canada	s.q.	0.50	5	Reserve Bank of Australia	s.q.	1.50
6	Reserve Bank of Australia	s.q.	1.50	6	Bank of Brazil	-100 b.p.	8.25
9	European Central Bank	s.q.	0.00	6	Bank of Canada	+25 b.p.	1.00
15	Federal Reserve	+25 b.p.	1.00	7	European Central Bank	s.q.	0.00
15	Bank of Japan	s.q.	-0.10	7	Bank of Sweden	s.q.	-0.50
16	Bank of England	s.q.	0.25	14	Bank of England	s.q.	0.25
16	Bank of Norway	s.q.	0.50	14	Swiss National Bank	s.q.	-0.75
16	Swiss National Bank	s.q.	-0.75	20	Bank of Japan	s.q.	-0.10
22	Reserve Bank of New Zealand	s.q.	1.75	20	Federal Reserve	s.q.	1.25
30	Bank of Mexico	+25 b.p.	6.50	21	Bank of Norway	s.q.	0.50
April				27	Reserve Bank of New Zealand	s.q.	1.75
4	Reserve Bank of Australia	s.q.	1.50	28	Bank of Mexico	s.q.	7.00
12	Bank of Korea	s.q.	1.25	October			
12	Bank of Brazil	-100 b.p.	11.25	3	Reserve Bank of Australia	s.q.	1.50
12	Bank of Canada	s.q.	0.50	18	Bank of Korea	s.q.	1.25
26	Bank of Japan	s.q.	-0.10	25	Bank of Canada	s.q.	1.00
27	European Central Bank	s.q.	0.00	25	Bank of Brazil		
27	Bank of Sweden	s.q.	-0.50	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	30	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	Bank of Japan	s.q.	-0.10	14	European Central Bank		
15	Swiss National Bank	s.q.	-0.75	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		
				20	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.