Daily Economic Update

April 24, 2019

Bank of Canada shifts to neutral bias; takes an axe to 2019 growth forecast

- As expected, the overnight rate was held steady at 1.75% for a fourth consecutive meeting
- The BoC's 2019 GDP growth forecast was lowered to 1.2% from 1.7% previously—a more substantial downward revision than we expected
- GDP growth is expected to average just 0.8% annualized over the first half of 2019 before picking up later this year and returning to around 2% in 2020 and 2021
- The bank's estimate of the neutral policy rate was revised down by 25 bps to a 2.25-3.25% range—a dovish development (it means the BoC doesn't have to raise rates as much to get "home") that wasn't entirely unexpected

The Bank of Canada was widely expected to drop their mild tightening bias today and they did just that, now indicating current accommodation is warranted and Governing Council will "continue to evaluate the appropriate degree of monetary policy accommodation as new data arrive." A few other developments added to the dovish tone, including a sharp downward revision to their 2019 growth forecast (now several ticks below consensus) and a lower assumed neutral interest rate. The former means the economy is operating with a bit more slack than previously thought, while the latter indicates the current overnight rate is slightly less accommodative than previously assumed. The statement pointed to ongoing trade tensions, slower-than-expected global growth, and a dovish shift from other central banks—not exactly a global backdrop that supports further tightening from the BoC. It did, however, note that investment and exports outside the energy sector should be supported by high capacity utilization and strengthening global demand as 2019 progresses. Stabilization in housing and decent consumption growth will also contribute to a return to more trend-like (or slightly stronger) growth later this year.

While we agree with the BoC that Canadian GDP growth should pick up in the coming quarters, we don't expect activity will be strong enough on a sustained basis for the central bank to get back to raising interest rates. The bank's forecast for only modestly above-trend growth in 2020 and 2021 indicates excess capacity will only be absorbed slowly—in that respect, their shift to neutral seems appropriate. Although we don't see an argument for rate hikes at this stage, we also don't think an outlook that calls for continued low unemployment and near-2% inflation warrants a reversal of the BoC's recent moves. Our forecast assumes the overnight rate will be held at 1.75% through next year, so expect more steady rate decisions in the months ahead.

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