



Daily Economic Update

October 25, 2017

Bank of Canada holds steady but has a bias to tighten amid limited slack

As expected, the Bank of Canada took a pass on raising interest rates today after consecutive 25 basis point hikes at each of their last two meetings. While maintaining an explicit tightening bias, the policy statement sounded a bit more cautious and kept a good deal of flexibility on the pace at which stimulus will be withdrawn. The bank remains constructive on the economic outlook, noting broadly-based growth though still predicting a more modest pace of activity going forward as housing and consumer spending shift down a gear. With the economy's speed limit picking up amid productivity-enhancing business investment, they see the economy remaining fairly close to full capacity, or possibly modestly above, over the next year. Monetary policy remains data dependent and how growth shakes out relative to potential in the coming quarters will be an important factor in the pace of future rate increases.

Our current forecast is for the overnight rate to be raised to 2% by the end of next year. That assumes a rate hike in December, although such a move looks a bit less likely given the bank's more cautious tone today. There is a risk that the Bank of Canada holds off on resuming tightening until early 2018.

Highlights:

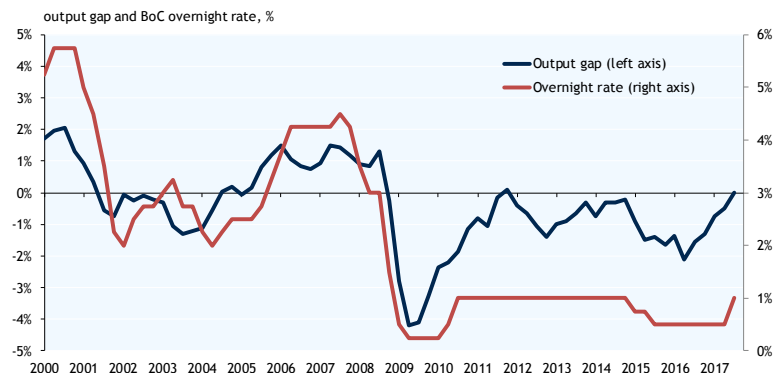
- The overnight rate was left unchanged at 1% after rate hikes in both July and September.
- The bank thinks the economy is operating close to its potential but noted some evidence of remaining labour market slack that could give the economy more room to run without generating inflation.
- Uncertainty around NAFTA renegotiation was cited as the main international risk to the economic outlook. A breakdown of talks would likely lead to a more cautious approach from the Bank of Canada.
- The bank expressed a tightening bias, noting less monetary policy stimulus is likely over time, but indicated they will proceed cautiously and will be guided by incoming data.
- The bank discussed whether some structural factors might be weighing on inflation but they remain of the view that the degree of slack in the economy is the main determinant of inflation.

GDP and inflation projections

	Q2/17	Q3/17	Q4/17	Q4/18	Q4/19
Bank of Canada					
Real GDP q/q	4.5	1.8	2.5		
July MPR	3.0	2.0	-		
Real GDP y/y	3.7	3.1	3.1	1.7	1.5
July MPR	3.4	2.8	2.7	1.8	1.5
CPI y/y	1.3	1.4	1.4	2.1	2.1
July MPR	1.4	1.3	1.6	2.0	2.1

Source: Bank of Canada, RBC Economics

Monetary policy remains accommodative despite limited slack in the economy



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