Uncertainty over Canada's economic outlook sets bar high for rate change, Poloz says

By David Parkinson
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Bank of Canada Governor Stephen Poloz suggested that continued uncertainties surrounding Canada's economic outlook have set the bar high for an interest rate change, as the central bank approaches its deliberations for next week's rate decision.

"The situation hasn't changed much, as far as I can see," Mr. Poloz said in the Q&A session following a speech in Toronto Monday evening.

He said the wide range of uncertainties that the bank outlined in its October rate decision, when it said it had considered a rate cut but opted to hold the line until more clarity had emerged on such issues as the U.S. election, the pace of Canadian trade, the evolution of the housing market and the impact of Canadian infrastructure spending "is still present. It's only been a few weeks."

"When there's that much uncertainty, it takes a big shock – like the oil price shock – to make it certain that you're knocked off your target," he said.

But in his press conference following the event, Mr. Poloz clarified that the bank isn't looking for "one big event" to shift it from its current wait-and-see stance on rates, but rather for more evidence on several economic fronts that would clarify the big picture.

"It's more an accumulation of evidence," he said.

He said the surprise election of Donald Trump as U.S. president did little to clear up that source of uncertainty to the outlook, and added that "we have hardly any additional [economic] data since then."

Mr. Poloz said new data coming between now and next week's Bank of Canada rate decision, especially Wednesday's third-quarter gross domestic product report, will provide the bank with some key additional indicators of the state of the economy.

"Those are big data points for us. It should help us bring things into focus."

Mr. Poloz also acknowledged Canada's accelerating services sector is leading the way to "fill the economic hole" left by declines in the country's manufacturing export capacity and deep losses in resource income.

"I strongly believe that the continued expansion of our service sector is pointing the way toward full economic recovery and the return of sustained, natural growth," Mr. Poloz said in a speech in Toronto to the Annual Benefactors' Dinner of C.D. Howe Institute, a private-sector economic policy think tank.

Mr. Poloz estimated that the hole left in the economy from the declines in manufacturing and resources amounts to "$80-billion to $90-billion," or more than 4 per cent of gross domestic product. But the hole is being refilled, he said.

"It kind of looks like we've filled about half of it," he estimated in the Q&A session following the speech.

He noted that even as global oil markets have slumped and Canada's exports have struggled to recover fully from the Great Recession because of a permanent loss of production capacity, the services sector has increased its exports by nearly one-third over the past five years, and growth in services has outpaced that of the goods sector in the postcrisis era. This is evidence of the economy's "creative destruction," he said, in which new technologies arise to create new businesses and jobs to replace capacity lost in traditional goods-producing sectors.

"This process has been gradual, more gradual than we would like, but based on the progress recorded to date, we have every confidence that the economy will find its way back to full output. As these new sources of growth add up, we will gradually absorb our excess capacity some time around mid-2018, and inflation will converge on our 2-per-cent target from below."

Mr. Poloz's speech built on the Bank of Canada's recent increased focus on the emergence of the services sector as a key engine as the Canadian economy undergoes an unsteady evolution away from resources as its key source of strength. The central bank dedicated a special section in its quarterly Monetary Policy Report in October to services' prominent role in the current economic recovery, and deputy governor Lawrence Schembri dedicated much of an early-November speech to the growth of Canada's services exports.

The speech was the last word from the Bank of Canada Governor prior to the bank's next interest rate announcement, on Dec. 7. The bank always observes a "blackout" period for one week prior to its rate decisions, when no senior officials at the bank speak publicly.

There is some speculation that the bank will consider an interest rate cut to help spur Canada's still-struggling economy – something the bank said it had considered in its previous decision in October, when it slashed its economic and inflation outlook. But Mr. Poloz steered clear of discussing near-term monetary policy in his speech.

The speech was also Mr. Poloz's first since the Nov. 8 U.S. presidential election, in which Mr. Trump was the surprise winner. Given Mr. Trump's protectionist trade rhetoric during the campaign, his victory raises new worries about the future for Canadian exports to the United States, a critical component of the central bank's road map for Canada's economic recovery.

While he didn't address the change in leadership in Canada's biggest trading partner in his speech, Mr. Poloz did comment on Mr. Trump's potential position on trade in an interview with Bloomberg TV earlier in the day.

"Certainly the rhetoric was a source of concern," Mr. Poloz said.

"Canada is very reliant on trade. Anything that disturbs that is a question mark," he said.

During the postspeech Q&A, Mr. Poloz acknowledged that the central bank will have to take into consideration in its economic calculations the impact of higher yields in the global bond markets resulting from Mr. Trump's election, as traders have bet the president-elect will increase government stimulus spending.

"The markets have run away with what they perceive as more of a positive thing" from Mr. Trump's election, he noted. "We'll have to wait and see."