Poloz maintains interest rates won't solve Toronto's housing mess

By David Parkinson
April 13, 2017 – *The Globe and Mail*

The Bank of Canada remains clear that it doesn't want to use its interest rates to put the brakes on the runaway Toronto-area housing market. But at the same time, the path is in sight for the bank to contribute a rate hike or two to the solution.

In discussing its latest interest rate decision and quarterly economic outlook Wednesday, the Bank of Canada sounded perhaps more concerned than ever about a rising housing tide in and around Canada's biggest city. It has now started to talk about the price surge as a "Golden Horseshoe" issue, reflecting its widening geographic spread in Canada's biggest regional economy. Bank of Canada Governor Stephen Poloz used the word "unsustainable," and said that "of course it's vulnerable to a correction." And he repeated the bank's position that if the chips were to fall badly, this poses a meaningful risk to the stability of the country's financial system.

Yet the bank held its key interest rate steady at a thin 0.5 per cent, where it has now sat for more than 20 months – something Mr. Poloz acknowledged has helped juice housing demand in parts of the country, most notably the Toronto and Vancouver areas.

Mr. Poloz is sticking to his long-held guns that interest rates, while they may have helped get us into this housing mess, are not the best tool to get us out of it.

Specifically, Mr. Poloz said that when it comes to the central bank balancing its mandate of pursuing its 2-per-cent inflation target (which is, by proxy, a goal of getting economic growth close to its sustainable potential) against its management of financial risks, the inflation target takes precedence.

The housing situation would have to become so precarious that it actually threatened the path to reaching the inflation target, he said, before it would justify interest rate action.

But while the central bank is clearly not about to raise rates solely to lean against the housing market, the strength of the economy may be opening a fortuitous window for it to raise interest rates for its preferred economic reasons – and, in doing so, lend a timely hand to the efforts to rein in the housing market.

Despite the bank's continued best efforts to find the dark lining on every silver economic cloud, the bottom line of its updated economic outlook is that the economy will reach full capacity some time in the first-half of 2018 – which, if you take the midpoint of that time frame, implies roughly one quarter sooner than the bank's previous forecast of mid-2018. It's typical that the central bank would start to look at raising rates as the economy neared full capacity, to nip inflationary pressures in the bud, rather than waiting for it to definitively reach full speed; so, a rate hike by early 2018 is now a distinct possibility.

Could it come sooner? Absolutely. By its own admission, the Bank of Canada is being pretty cautious in its outlook. It is erring on the side of the recent growth surge being fuelled largely by temporary factors; pretty much everywhere it has raised its near-term forecasts, it has offset them with similar trims to its longer-term projections. It's not willing to book the past several months of upturn as a true trend until it has seen the whites of its eyes. And it's very wary of the looming risks, particularly from U.S. trade policy, that could seriously derail Canadian growth.

But in terms of the straight economic trajectory, the risks to the bank's outlook appear tilted to the upside. If the bank's caution proves unfounded, and the recent economic surge is maintained and built upon, then a rate hike before the end of this year is not out of the question. That could be followed by at least one more hike by the middle of next year.

How meaningful would that be to addressing the Toronto housing extremes? It's hard to say. Mr. Poloz made the point that some relatively small rate increases from the current historically low levels won't meaningfully dissuade speculators who are drooling at the prospect of 30-per-cent annual price increases, which he increasingly believes is the main driver of the Horseshoe's price frenzy. Still, there's little doubt that rising interest rates would discourage demand more generally, and thus would have an overall chilling effect on the marketplace – especially if they coincided with other policy efforts being contemplated at the municipal and provincial levels.

The Bank of Canada's own rising concern about the Toronto housing frenzy might motivate it to lean toward beginning rate increases earlier rather than later, as long as the economy continues to build on its gains. Still, turning central-bank policy direction is like turning a cruise ship – course changes are slow, gradual, and with great care not to make the passengers seasick. Overheated housing markets can be particularly sensitive things in this regard.

So, the Bank of Canada isn't going to make any drastic pronouncements that would rock the boat, be it in housing, the financial markets or the broader economy. Still, Wednesday's cautious shift in outlook suggests that the turn may have begun. Regardless of the motivations behind it, it could prove timely for Toronto's housing dilemma.