Bank of Canada will continue with gradual rate hikes

By David Ljunggren
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The Bank of Canada will continue to raise interest rates gradually, Governor Stephen Poloz said on Thursday, stressing that despite economic uncertainties, the bank did not want to let inflation momentum build.

The central bank has raised rates four times since July 2017 and most market players expect another hike on Oct. 24. Poloz said that while the bank did not know exactly where the economy was heading, that did not justify inaction.

"It does not mean keeping interest rates on hold until inflation momentum starts to build," he said in a speech in Moncton, New Brunswick.

"The bank will continue to follow a gradual approach to raising interest rates, and remain dependent on incoming data and other sources of information to guide our decisions," the governor added.

Market expectations of an interest rate hike in October, as reflected in the overnight index swaps market, rose slightly to 76.46 per cent from 72.36 per cent before the speech.

Although the annual inflation rate in August was 2.8 per cent, well above the bank's 2.0 per cent target, Poloz said that was partly due to the boost provided by temporary factors such as higher gas prices.

Poloz, who cited the inflation rate and very low unemployment, said in his speech that the economy was operating near capacity.

"We know that if we move too slowly to raise interest rates, the economy could move firmly above its capacity limits and inflation could establish significant momentum. We certainly want to avoid this outcome," he said.

That said, new digital technologies could be giving the economy more room to grow before inflation pressure emerged.

"Raising interest rates too quickly could choke off this economic growth unnecessarily," Poloz continued.

The bank left rates unchanged on Sept. 5 and Poloz said policy-makers had pondered at the time whether the gradual approach to raising rates was still appropriate, given that its economic forecasts were on target.

The bank discussed whether the data coming in as planned "was a reason for more moving more quickly … and our conclusion was no, we still have a number of uncertainties we are carrying," he told a news conference after the speech.

One important unknown was the fate of talks to renegotiate NAFTA, he said. Talks on the pact have stalled.

Poloz earlier told his audience that if the North American Free Trade Agreement were successfully renewed, investment spending should pick up, and that would "give us a longer period of non-inflationary growth."

Poloz – reiterating a point the bank made earlier this month – said if relations with the United States worsened and the economy slowed, that would not necessarily prompt a rate cut.

If for example, Washington carried through on a threat to impose tariffs on Canadian autos and Canada retaliated, prices would rise, and that could be "very risky" for the inflation outlook at a time when the economy was at capacity.

"If push comes to shove, our mandate is clear – it's about inflation," he said.