Bank of Canada holds rates steady, sees weak fourth quarter spilling into early 2020

By Bill Curry
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Bank of Canada Governor Stephen Poloz said weaker economic growth in the fourth quarter is spilling into the early part of 2020 and signalled a possible interest rate cut should that weakness continue.

As expected, the bank kept its key policy rate at 1.75 per cent, where it has been for the past 16 months. That decision is based on the view that the current soft patch in the economy is largely driven by temporary factors, such as an early winter on the Prairies and last year's Canadian National Railway Co. strike.

The recent easing of global trade tensions is expected to support stronger growth as the year progresses.

If that turnaround doesn't materialize, Mr. Poloz told reporters Wednesday the bank will consider a rate cut.

"I'm not saying that the door's not open to an interest rate cut. Obviously it is. It is open," he said. "But it hinges how the data evolve from here … We have a strong belief that this will prove temporary, but temporary could be longer or shorter, and to the extent that it's longer … we would have to come back to that decision, to decide then whether or not the interest rate as it is today remains appropriate."

The odds of a rate cut at its next announcement in March rose on Wednesday to 24.1 per cent, and the chances of a cut by June jumped to 57.7 per cent, according to bond-market pricing tracked by Bloomberg after the bank's announcement.

The Canadian dollar was down 0.41 US cents as of midafternoon Wednesday, to US$0.76, and bond yields dropped as well, with the two-year Government of Canada bond down seven basis points to 1.56 per cent.

Several bank economists described the bank's statements as more dovish than expected.

"Today's statement makes us more comfortable with our call for a rate cut in April," Royal Bank of Canada senior economist Josh Nye said in a note.

But National Bank Financial Markets economists said in a research note that despite the change in tone from the central bank, they are not predicting a rate cut before Mr. Poloz's term expires in June.

"Market expectations aside, Governor Poloz may well have reason enough to spend the remainder of his seven-year term in cruise control," they wrote.

In addition to the rate announcement, the bank also released its quarterly monetary policy report, which provides an in-depth analysis of global and domestic economic trends.

Wednesday's report is the bank's first detailed forecast since two major trade developments: the initial agreement between the United States and China to ease tariffs and the fact that the new trade deal between Canada, the U.S. and Mexico has moved into the final stages of ratification. The two developments lifted some of the global trade uncertainty hovering over the Canadian economic outlook in recent years.

Citing temporary factors, the bank revised its estimate for fourth quarter growth to 0.3 per cent annualized growth, down from 1.3 per cent. It now expects 1.3-per-cent growth in the first quarter of 2020, down from an earlier forecast of 1.7 per cent.

The bank made slight adjustments to its projections for annual gross domestic product growth. It now says the economy grew by 1.6

per cent in 2019, up from its previous forecast of 1.5 per cent. The projection for 2020 is now 1.6 per cent, down from 1.7 per cent, while the 2021 forecast is 2 per cent, up from 1.8 per cent.

Inflation is projected to stay around the bank's target of 2 per cent.

In a news release, the bank said there is some uncertainty as to how long the current slowdown will last.

"In determining the future path for the bank's policy interest rate, governing council will be watching closely to see if the recent slowdown in growth is more persistent than forecast," the bank said Wednesday. "In assessing incoming data, the bank will be paying particular attention to developments in consumer spending, the housing market and business investment."

The Canadian economy continues to run at two speeds, with prolonged challenges in the oil and gas sector dampening the strength found in other sectors of the economy. While economic activity in the oil and gas sector is still well below what it was prior to the drop in oil prices that started in 2014, the bank said there are early indications that the sector is stabilizing.

During a news conference, senior deputy Governor Carolyn Wilkins commented on the government's December announcement that it is reviewing the terms of the mortgage stress test, which is meant to ensure Canadians can manage their borrowing costs even if interest rates were to rise.

Ms. Wilkins said the stress test "has done a very good job of safeguarding the system" and that the government appears to be looking at tweaks, rather than loosening borrowing rules.