Economic Comment on Bank of Canada's Rate Rise

***e*Research Corporation** is pleased to provide a commentary by Capital Economics on today's announcement by the Bank of Canada that it is raising the interest rate to 0.75% from 0.50%. This move was highly anticipated by the Street. However, Capital Economics had reservations as to the wisdom of such a move by the BoC, and continues in this vein by conjecturing that the BoC may not need to raise rates further this year.

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Bank of Canada Hikes Policy Rate To 0.75%

Despite core inflation falling further below target, the Bank of Canada's decision today to raise interest rates to 0.75%, from 0.50%, and signal that some further removal of policy stimulus in the future show that it is supremely confident in the economy and, in particular, the housing market. In short, this is a bold policy call, particularly for a central bank that defines its success exclusively in terms of achieving its inflation target.

The Bank highlighted in its statement that the recent economic data has bolstered their confidence in the "economic outlook for above-potential growth and the absorption of excess capacity in the economy". In addition, the Bank determined that the recent softness in inflation is merely a temporary thing and is convinced that it will rebound, as the excess slack in the economy is eliminated by year end and wage growth picks up.

On that basis, the Bank's Governing Council "judges that the current outlook warrants today's withdrawal of some of the monetary policy stimulus in the economy" and that "future adjustments to the target for the overnight rate will be guided by incoming data….keeping in mind continued uncertainty and financial system vulnerabilities".

In some ways the policy statement was quite bizarre, as it made no explicit mention of housing at all. This is perhaps because they aren't concerned at all, or, more likely, that they are really concerned and don't want to mention anything right now until it is clearer as to the exact state of the housing market. That said, the Bank will get grilled on this topic in the upcoming press conference set to start in roughly an hour from now.

Overall, today's policy statement was more hawkish than we had expected and, needless to say, this means that there is some upside risk to year-end forecast of US$0.75 for the Canadian dollar. We still think, however, that the economy is on the verge of a slowdown due to housing-related weaknesses, which will be reinforced by higher household borrowing costs. As we move though the year, we expect this weakness to become self-evident and this to put the brake on talk of further interest rate hikes.

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Note: All of the comments, views, opinions, suggestions, recommendations, etc., contained in this report are strictly those of the Author and do not necessarily reflect those of *e*Research Corporation.

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