BoC's Poloz Strikes An Upbeat Tone

- **Governor Poloz's speech (here) generally supports expectations for a hike at the October meeting and proceeding gradually thereafter.** Some might even label three hikes in a full calendar year as proceeding more at a glacial rather than gradual speed. So far, the C$ is little affected by the speech going into the Asian overnight session. This note is being sent pending the Governor's press conference which may carry additional risk including what is highlighted below.

- The speech's opening line set the tone for what is generally an upbeat speech:

> "The Canadian economy has been doing quite well overall for the past year. Yes, growth has been a bit choppy and regionally uneven. But the economy as a whole has finally recovered from the global financial crisis of 2008 and the 2014 collapse in oil prices. Inflation is close to target, the economy is operating at capacity, and unemployment is very low."

- The quote that may inform policy guidance that weighs sundry forms of uncertainty while still leaning toward a nearer term hike is as follows. This is not entirely new, but repeating it serves as guidance the BoC remains on track to continue hiking.

> "**Of course, being uncertain about the future does not justify inaction.** It does not mean keeping interest rates on hold until inflation momentum begins to build. What it does mean is that we will move rates toward a more neutral level gradually, continuously updating our judgment on these key issues in real time."

- **As an aside, there is no effort in this speech to expand upon the criteria for perhaps one day dropping 'gradual'** on the back of SDG Wilkin's remark that the Governing Council debated whether to do so at the September 5th meeting and opted to retain the wording at least for now. Perhaps the Governor will be asked in the press conference to elaborate upon the criteria for doing so with more probing insight than general data dependence. For instance, would the Governor put an expedited spin on 'gradual' if, say, we got a combination of limited fiscal stimulus and a NAFTA deal? Again, for an economy at capacity with negative real rates in the ballpark of negative real policy rates in Europe and Japan, three hikes a year seems extraordinarily gradual.

- Poloz goes on to translate the economy's performance into capacity limits and inflation pressures. He is likely referring to the average of the output gaps that has shut:

> **"Our economic models are saying that the economy is operating essentially right around capacity.** The recent behaviour of inflation backs this up. Our core measures of inflation have been trending very close to 2 per cent, which is what you would expect from an economy operating at capacity."

- Poloz goes on to repeat that "Today, we continue to judge that higher interest rates will be warranted to achieve our inflation target." That's not a new message, but it reaffirms a continued hiking bias in the face of various uncertainties.

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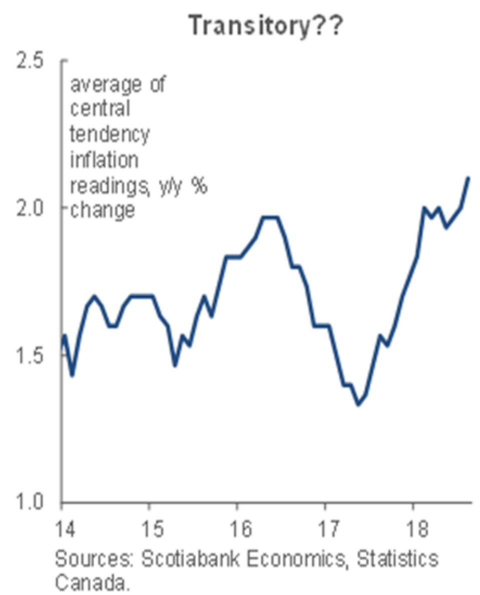

- I personally think Poloz continues to over-emphasize the tech influences upon inflation, but he relies heavily upon it in the following quote that explains balanced risks to going either too quickly or too slowly on rates:

> "And 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. At the same time, there are risks in the other direction. In particular, new digital technologies could be giving the economy more room to grow before inflation pressures emerge. Raising interest rates too quickly could choke off this economic growth unnecessarily. The situation makes monetary policy decidedly data dependent."

- **If there is an area where I'm skeptical of the arguments being offered then it lies in terms of continued dismissal of pressures on inflation and the tendency to explain them away as transitory**. Here is what the Governor stated:

> "The latest inflation reading was above target at 2.8 per cent, but 0.5 percentage points of that came from the temporary impact of higher gasoline costs, and 0.3 points came from the cost of air travel, which should also affect inflation only temporarily."

- He's right with this points, but there are other important ways of looking at pressures upon inflation. Like the chart below. It shows the average of the three central tendency measures taking off since the summer of 2017 through to the August 2018 reading. By nature, they weed out the outlier influences upon prices. Headline may be overshooting, but it may be dangerous to downplay the momentum reflected in the fourteen month long upswing in core inflation. Or consider the inflation evidence at the margin; July CPI soared by 0.5% m/m SA and the three month average is tracking at 0.27% which annualizes to pressures well above target. It's possible that the three month moving average of seasonally adjusted month-ago price changes will be proven transitory, but there is breadth to the rise, and caution might lean as much toward entertaining the possibility that the pick-up is not transitory.
- On Nafta, Poloz said he is optimistic that "some form" of NAFTA agreement will emerge. Having said that, he also said "And we cannot know to what extent the NAFTA negotiations and global trade policy uncertainty are slowing business investment decisions." Yes, in real time, we can't factually assess attitudes to investment. But the available data has generally shown resilience in terms of actual investment, intentions, and foreign direct investment into Canada. Are we data dependent, or not?
- The full speech is available here. Governor Poloz will deliver a press conference at 7pmET.