

The Bank of Canada: How High, How Fast?

- The global economy continues to surpass expectations. The acceleration in growth is broadly-based across both firms and households, and it is getting a powerful boost from a mix of high confidence, strong sales activity, rising incomes, and still very low interest rates.
- Nowhere is this more evident than in Canada, the growth leader among G7 economies. We now expect growth to surpass 3% in 2017, the strongest it's been since 2011, before slowing to about 2% in 2018. Of particular note in Canada is the breadth of activity: most provinces are growing rapidly, in sharp contrast to previous years, and there is broad strength across many sectors of the economy.
- **Strong growth and its impact on inflation will lead the Bank of Canada to raise interest rates well beyond current levels** (chart 1). We currently forecast that the Bank of Canada will raise interest rates one more time this year in December, followed by two more rate increases during 2018. This is conditioned on our view that there remains a solid link between inflation and the output gap (the difference between the actual level of GDP and potential GDP) once unit labour costs, the exchange rate, and oil prices are taken into account (chart 2). Though growth is expected to slow in 2018, it would remain well above estimates of potential growth, which implies greater inflationary pressures through the year. Additional rate increases will likely be required in 2019.
- While the exact timing of the next rate increase is uncertain, in our view, economic conditions are such that every **Bank of Canada meeting for the foreseeable future should be considered a “live” meeting in which there is a reasonable chance of a rate increase**. This includes the next decision date in October, even though we currently think the Bank's next rate move is more likely to be in December given the risks highlighted in the Bank of Canada's [September rate decision](#).
- **Even more rate increases would be required in 2018 were it not for our expectation that the Canadian dollar will appreciate substantially** over the coming year and act to cool growth and inflation somewhat. The loonie should appreciate to 83 cents by the end of 2017 and rise further to 87 cents by end-2018. This is based on our view that Canadian interest rates will rise more rapidly than expected at present by the market and narrow the rate differential between Canada and the US amidst a continued global move away from the US dollar. Oil is not anticipated to have much influence over the loonie through next year given that we forecast a relatively flat profile for crude over this time.

CONTACTS

Jean-François Perrault, SVP & Chief Economist
416.866.4214
Scotiabank Economics
jean-francois.perrault@scotiabank.com

Chart 1

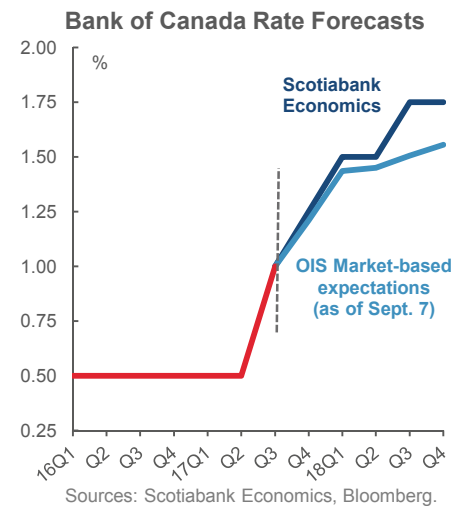
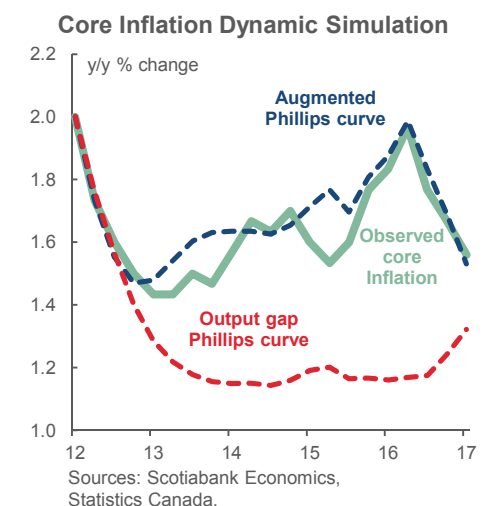


Chart 2



International	2000–15	2016	2017f	2018f	2000–15	2016	2017f	2018f
World (based on purchasing power parity)	3.9	3.2	3.6	3.6				
Canada	2.2	1.5	3.1	2.0	1.9	1.4	1.5	2.0
United States	2.0	1.5	2.2	2.3	2.2	1.8	1.8	2.3
Mexico	2.4	2.3	2.4	2.7	4.5	3.4	6.5	4.3
United Kingdom	1.8	1.8	1.6	1.2	2.2	0.7	3.0	2.3
Euro zone	1.2	1.6	2.2	2.0	1.9	1.1	1.4	1.7
Germany	1.2	1.7	1.8	1.7	1.6	1.7	1.5	1.8
France	1.3	1.2	1.4	1.6	1.7	0.6	1.3	1.4
Russia	4.6	-0.2	1.4	1.4	11.4	5.4	4.4	4.0
China	9.8	6.7	6.7	6.3	2.4	2.1	2.0	2.5
India	7.0	7.6	6.6	7.6	7.2	3.4	4.1	5.1
Japan	0.9	1.0	1.7	1.0	0.0	0.3	0.6	1.1
South Korea	4.4	2.8	2.8	2.7	2.8	1.3	2.0	2.3
Indonesia	5.6	5.0	5.2	5.5	6.2	3.0	4.0	4.7
Australia	3.0	2.5	2.4	2.7	2.9	1.5	2.0	2.1
Thailand	4.2	3.2	3.3	3.2	2.7	1.1	0.3	1.5
Brazil	3.4	-3.6	0.3	2.5	6.5	6.3	4.0	4.5
Colombia	4.3	2.0	1.9	2.2	5.0	5.7	4.2	3.5
Peru	5.3	4.0	2.5	3.7	2.7	3.2	2.8	2.8
Chile	4.3	1.6	1.4	2.8	3.3	2.7	2.6	2.9
Commodities								
				(annual average)				
WTI Oil (USD/bbl)	64	43	51	53				
Brent Oil (USD/bbl)	67	45	53	56				
Nymex Natural Gas (USD/mmbtu)	5.09	2.55	3.10	2.95				
Copper (USD/lb)	2.36	2.21	2.55	2.75				
Zinc (USD/lb)	0.81	0.95	1.25	1.40				
Nickel (USD/lb)	7.45	4.36	4.40	5.00				
Aluminium (USD/lb)	0.87	0.73	0.85	0.85				
Iron Ore (USD/tonne)	68	58	65	60				
Metallurgical Coal (USD/tonne)	127	115	185	125				
Gold, London PM Fix (USD/oz)	845	1,251	1,225	1,250				

North America	2000–15	2016	2017f	2018f	2000–15	2016	2017f	2018f
	Canada				United States			
	(annual % change, unless noted)				(annual % change, unless noted)			
Real GDP	2.2	1.5	3.1	2.0	2.0	1.5	2.2	2.3
Consumer spending	2.9	2.3	3.5	2.0	2.3	2.7	2.7	2.6
Residential investment	3.8	3.0	2.7	-1.3	-0.8	5.5	2.2	1.9
Business investment	2.7	-7.8	1.6	3.6	2.4	-0.6	4.4	3.4
Government	2.2	1.8	2.0	2.0	1.0	0.8	0.1	0.7
Exports	1.3	1.0	3.1	3.8	3.9	-0.3	3.2	2.7
Imports	3.1	-0.9	3.9	3.1	3.5	1.3	3.9	3.4
Nominal GDP	4.4	2.1	5.6	4.2	4.0	2.8	4.0	4.3
GDP deflator	2.2	0.6	2.4	2.2	2.0	1.3	1.8	2.0
Consumer price index (CPI)	2.0	1.4	1.5	1.8	2.2	1.3	2.0	2.1
CPI ex. food & energy	1.6	1.9	1.6	1.7	2.0	2.2	1.8	2.2
Pre-tax corporate profits	3.9	-4.5	22.0	5.0	6.0	-2.1	4.5	3.5
Employment	1.4	0.7	1.7	1.0	0.6	1.8	1.5	1.2
Unemployment rate (%)	7.1	7.0	6.5	6.3	6.3	4.9	4.4	4.3
Current account balance (CAD, USD bn)	-13.9	-67.0	-60.5	-57.3	-511	-452	-466	-519
Merchandise trade balance (CAD, USD bn)	28.2	-26.0	-16.7	-16.2	-668	-753	-811	-879
Federal budget balance (FY, CAD, USD bn)	-2.9	-1.0	-22.0	-22.0	-529	-585	-665	-675
percent of GDP	-0.2	0.0	-1.1	-1.0	-3.8	-3.1	-3.4	-3.3
Housing starts (000s, mn)	199	198	210	195	1.27	1.18	1.23	1.30
Motor vehicle sales (000s, mn)	1,639	1,949	2,000	1,980	15.4	17.5	17.1	17.4
Industrial production	0.5	-0.3	5.9	2.1	0.8	-1.2	1.9	2.2
	Mexico							
	(annual % change)							
Real GDP	2.4	2.3	2.4	2.7				
Consumer price index (year-end)	4.5	3.4	6.5	4.3				
Current account balance (USD bn)	-14.0	-27.9	-20.7	-28.1				
Merchandise trade balance (USD bn)	-6.8	-13.1	-7.8	-10.6				

Quarterly Forecasts	2016				2017				2018			
Canada	Q1	Q2	Q3	Q4	Q1	Q2	Q3f	Q4f	Q1f	Q2f	Q3f	Q4f
Real GDP (q/q ann. % change)	2.8	-1.4	4.2	2.7	3.7	4.5	2.4	2.2	1.7	1.7	1.6	1.6
Real GDP (y/y % change)	1.3	1.1	1.5	2.0	2.3	3.7	3.3	3.2	2.7	2.0	1.8	1.6
Consumer prices (y/y % change)	1.5	1.6	1.2	1.4	1.9	1.3	1.4	1.5	1.6	1.8	2.0	2.0
CPI ex. food & energy (y/y % change)	1.7	2.0	2.0	1.8	2.0	1.4	1.5	1.5	1.6	1.7	1.8	1.8
Avg. of new core CPIs (y/y % change)	1.8	2.0	1.8	1.7	1.6	1.4	1.5	1.5	1.6	1.7	1.8	1.8
United States												
Real GDP (q/q ann. % change)	0.6	2.2	2.8	1.8	1.2	3.0	2.5	2.5	2.2	2.1	2.0	2.0
Real GDP (y/y % change)	1.4	1.2	1.5	1.8	2.0	2.2	2.1	2.3	2.6	2.3	2.2	2.1
Consumer prices (y/y % change)	1.1	1.1	1.1	1.8	2.6	1.9	1.8	1.8	1.8	2.2	2.3	2.3
CPI ex. food & energy (y/y % change)	2.2	2.2	2.2	2.2	2.2	1.8	1.7	1.8	1.8	2.2	2.3	2.3

Central Bank Rates	2016		2017				2018			
	Q3	Q4	Q1	Q2	Q3f	Q4f	Q1f	Q2f	Q3f	Q4f
Americas	(% , end of period)									
Bank of Canada	0.50	0.50	0.50	0.50	1.00	1.25	1.50	1.50	1.75	1.75
US Federal Reserve (upper bound)	0.50	0.75	1.00	1.25	1.25	1.50	1.50	1.75	1.75	2.00
Bank of Mexico	4.75	5.75	6.50	7.00	7.00	7.25	7.50	7.50	7.50	7.50
Central Bank of Brazil	14.25	13.75	12.25	10.25	8.25	8.00	7.75	7.50	7.50	7.50
Bank of the Republic of Colombia	7.75	7.50	7.00	5.75	5.25	5.25	5.25	5.25	5.25	5.25
Central Reserve Bank of Peru	4.25	4.25	4.25	4.00	3.50	3.50	3.50	3.50	3.50	3.50
Central Bank of Chile	3.50	3.50	3.00	2.50	2.50	2.50	2.50	2.75	3.00	3.25
Europe										
European Central Bank	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Bank of England	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.50	0.50
Swiss National Bank	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75
Asia/Oceania										
Reserve Bank of Australia	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.75
Bank of Japan	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10
People's Bank of China	4.35	4.35	4.35	4.35	4.35	4.35	4.35	4.35	4.35	4.35
Reserve Bank of India	6.50	6.25	6.25	6.25	6.00	6.00	6.00	6.00	6.00	6.00
Bank of Korea	1.25	1.25	1.25	1.25	1.25	1.25	1.25	1.50	1.50	1.75
Bank Indonesia	5.00	4.75	4.75	4.75	4.50	4.50	4.50	4.75	4.75	5.00
Bank of Thailand	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.75	1.75	2.00
Currencies and Interest Rates										
Americas	(end of period)									
Canadian Dollar (USDCAD)	1.31	1.34	1.33	1.30	1.20	1.20	1.18	1.18	1.15	1.15
Canadian Dollar (CADUSD)	0.76	0.74	0.75	0.77	0.83	0.83	0.85	0.85	0.87	0.87
Mexican Peso (USDMXN)	19.39	20.73	18.72	18.12	18.25	18.82	19.01	18.87	18.93	19.18
Brazilian Real (USDBRL)	3.26	3.26	3.12	3.31	3.00	3.35	3.30	3.30	3.30	3.30
Colombian Peso (USDCOP)	2,882	3,002	2,874	3,046	3,015	3,005	3,100	3,100	3,050	3,000
Peruvian Nuevo Sol (USDPEN)	3.38	3.36	3.25	3.25	3.24	3.22	3.20	3.19	3.17	3.18
Chilean Peso (USDCLP)	657	670	660	664	635	641	639	636	634	631
Europe										
Euro (EURUSD)	1.12	1.05	1.07	1.14	1.18	1.18	1.18	1.18	1.20	1.20
U.K. Pound (GBPUSD)	1.30	1.23	1.26	1.30	1.28	1.28	1.28	1.28	1.31	1.31
Swiss Franc (USDCHF)	0.97	1.02	1.00	0.96	0.93	0.97	0.97	0.97	0.95	0.95
Asia/Oceania										
Japanese Yen (USDJPY)	101	117	111	112	110	110	112	112	115	115
Australian Dollar (AUDUSD)	0.77	0.72	0.76	0.77	0.75	0.75	0.77	0.77	0.78	0.78
Chinese Yuan (USDCNY)	6.67	6.95	6.89	6.78	6.50	6.50	6.45	6.40	6.35	6.30
Indian Rupee (USDINR)	66.6	67.9	64.9	64.6	64.5	65.0	64.5	64.5	64.0	64.0
South Korean Won (USDKRW)	1,101	1,208	1,118	1,144	1,140	1,160	1,140	1,140	1,120	1,120
Indonesian Rupiah (USDIDR)	13,042	13,473	13,326	13,328	13,350	13,400	13,350	13,350	13,300	13,300
Thai Baht (USDTHB)	34.6	35.8	34.4	34.0	33.4	33.6	33.4	33.4	33.2	33.2
Canada (Yields, %)										
3-month T-bill	0.53	0.46	0.55	0.71	1.00	1.30	1.55	1.60	1.80	1.85
2-year Canada	0.52	0.75	0.75	1.10	1.50	1.75	1.85	1.95	2.00	2.05
5-year Canada	0.62	1.11	1.12	1.39	1.70	1.95	2.05	2.15	2.20	2.25
10-year Canada	1.00	1.72	1.63	1.76	2.00	2.15	2.25	2.35	2.45	2.60
30-year Canada	1.66	2.31	2.30	2.15	2.35	2.50	2.55	2.60	2.75	2.95
United States (Yields, %)										
3-month T-bill	0.27	0.50	0.75	1.01	1.05	1.35	1.40	1.65	1.70	2.00
2-year Treasury	0.76	1.19	1.25	1.38	1.30	1.55	1.75	1.85	1.95	2.10
5-year Treasury	1.15	1.93	1.92	1.89	1.70	1.85	2.00	2.15	2.25	2.35
10-year Treasury	1.59	2.44	2.39	2.30	2.10	2.25	2.35	2.45	2.60	2.75
30-year Treasury	2.31	3.07	3.01	2.83	2.70	2.75	2.80	2.85	3.00	3.20

The Provinces

(annual % change, except where noted)

Real GDP	CA	NL	PE	NS	NB	QC	ON	MB	SK	AB	BC
2000–15	2.2	2.5	1.8	1.4	1.2	1.7	2.0	2.4	2.1	3.1	2.7
2016p*	1.5	1.9	2.4	0.9	1.4	1.7	2.6	2.4	-1.0	-3.8	3.7
2017f	3.1	-1.7	1.6	1.5	1.2	2.9	3.2	2.6	1.9	3.4	3.5
2018f	2.0	-0.4	1.4	1.2	0.9	1.9	2.2	2.0	1.8	2.1	2.3
Nominal GDP											
2000–15	4.4	5.7	4.3	3.3	3.3	3.6	3.8	4.5	6.0	6.5	4.5
2016e	2.1	-0.1	3.7	2.4	2.5	3.0	4.2	3.7	-3.5	-6.0	5.4
2017f	5.6	2.5	3.5	3.5	3.1	5.0	5.5	4.7	5.0	7.0	5.9
2018f	4.2	2.7	3.1	3.0	2.7	3.8	4.4	3.8	4.0	4.8	4.5
Employment											
2000–15	1.4	1.0	1.2	0.7	0.5	1.3	1.3	1.0	1.3	2.5	1.2
2016	0.7	-1.5	-2.3	-0.4	-0.1	0.9	1.1	-0.4	-0.9	-1.6	3.2
2017f	1.7	-3.2	2.4	0.6	0.6	2.0	1.4	1.2	0.3	1.1	3.2
2018f	1.0	-1.0	0.3	0.2	0.2	0.9	1.1	0.7	0.7	0.9	1.2
Unemployment Rate (%)											
2000–15	7.1	14.3	11.2	8.9	9.6	8.1	7.2	5.1	4.9	4.9	6.6
2016	7.0	13.4	10.7	8.3	9.5	7.1	6.5	6.1	6.3	8.1	6.0
2017f	6.5	14.8	10.1	8.1	8.3	6.2	6.2	5.5	6.2	8.1	5.4
2018f	6.3	15.1	10.0	7.9	8.1	6.0	6.1	5.4	5.9	7.8	5.3
Housing Starts (units, 000s)											
2000–15	199	2.7	0.8	4.3	3.6	44	71	5.1	5.2	35	28
2016	198	1.4	0.6	3.8	1.8	39	75	5.3	4.8	25	42
2017f	210	1.1	0.9	4.1	1.7	42	80	7.1	4.8	28	40
2018f	195	1.1	0.7	3.8	1.8	38	74	6.0	4.6	27	38
Motor Vehicle Sales (units, 000s)											
2000–15	1,639	28	6	48	37	410	624	47	45	216	178
2016	1,949	33	9	54	44	458	807	55	51	220	218
2017f	2,000	31	8	54	42	456	822	59	59	245	224
2018f	1,980	29	7	54	41	450	812	58	60	248	221
Budget Balances, Fiscal Year Ending March 31 (CAD mn)											
2000–15**	-2,917	59	-39	-31	-146	-1,009	-5,215	-84	425	1,746	288
2016	-987	-2,207	-13	-13	-261	2,191	-3,515	-846	-675	-6,442	811
2017f	-22,000	-1,080	-18	150 [†]	-231	250	-991 [†]	-872	-1,354 [†]	-10,784 [†]	2,737 [†]
2018f	-22,000	-778	1	136	-156	0	0	-840	-685	-10,538	295

* Real GDP by industry at basic prices. ** MB:FY04–FY15; AB:FY05–FY15; SK:FY15–FY18f: ex. accrual adjustment for pension expense.

† Final FY17; other FY17 & FY18: Provinces' estimates.

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