

## **BOC rate hike July 12 2017 (Marc Goldfried)(5:39m)**

Marc Goldfried: The BOC did raise rates this morning by 0.25, from 0.5% to 0.75%. That's the first rate hike that the Bank of Canada has made since 2010, when Mark Carney raised rates three times post the financial market recession.

I think the BOC had a number of reasons for why they did it, I think you have to think about whether this is a normalization process or if the bank is removing stimulus because they are anticipating a great change in the inflation fundamentals. The bank started three months ago communicating a change in tact and they became more hawkish in the communications. I believe the bank is looking at future inflation and Canadian economy and are afraid they may have to "hit the breaks" much harder if they do not start the process now. When we think about what the BOC has done so far, we have to look back at 2015. In 2015, Governor Poloz lowered rates two times, in the response to lower oil and commodity prices, which had a major impact on the Canadian economy. Right now, we can look at this rate change, as a normalization of policy back to what it was pre-oil price collapse because in his opinion and judgment the Canadian economy has recovered sufficiently. Secondly, when the BOC is determining what future interest rates look like, they have a dual policy mandate: full employment and price stability. And right now the prices are a little bit low, but they see the prices moving higher. The term that the bank uses is an "output gap". The output gap is the difference between potential and realized growth in the economy and when the realized growth matches potential growth that is when you can expect a change in prices on goods and services, inflation moving higher. As you lose capacity and economic slack is absorbed, which is what has been happening for the last 12-18 months, you should expect inflation in the future. What the bank is doing now is two fold: responding to an output gap that is closing sooner than anticipated and normalizing policy, as it relates to the rate cuts made in 2015.

There has been some impact to the markets. One thing we have seen is a flatter yield curve, meaning that long bonds are moving up higher in price and short bonds are dropping price, which changes the yield curve. That is a normal experience when the bank raises rates or beginning a hiking cycle. Primarily, the market has not moved too much, we already backed our 45-50bps on interest rates in anticipation of the rate hike and the CAD dollar has rallied sufficiently. Our expectation before today was that if the BOC hadn't gone, the CAD dollar probably would have sold off. What we see today is a slight improvement in the CAD dollar but majority of that move has already occurred.

The central bank would not tell you our right what they are doing and you have to read the tea leaves a little bit. I was reading through the statement and there is nothing specific about what the future path of rate hike is. This does not look exactly like the FOMC who has a dot-plot diagram and they are very consistent in what they communicate to the market place. The question goes back to what I was talking about earlier: are they concerned that inflation is getting out of control or are they normalizing policy, or is it a combination of the two? That is really hard to say right now, I think that we will see for sure another rate hike by the end of the year to get the overnight rate to 1%, where it was before the cuts of 2015. At which point the bank will be dependent, they will have to actually see evidence of inflation to continue on a policy of stimulus removal plan.

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Rates look like they are moving up in US, certainly look like they are going up in Canada; we have seen a turn around in global interest rates and other central banks around the world starting to discuss start removal of policy stimulus. We expect to see globally to see interest go high, so you have to think about which market provides better outcomes of returns in a higher interest rate environment. Frankly, I don't like the construct of the Canadian market, as the duration is very long so you take a lot of interest rate risk, and we don't have enough investable credit sectors in Canada to provide the kind of cash flow and coupon income in order to protect the downside, with corporates only being 27% of the benchmark. So with the current environment, I prefer the U.S. market, yield are much higher and much bigger investable credit markets, a lot more yield for a lot less interest risk. As such I continue to recommend the [Canoe Global Income Fund](#), as the best product, all around fixed income solution for the environment we are in right now, which is we believe is a higher interest rate environment.

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