

# Bank of Canada raises interest rate for 1st time in 7 years to 0.75%

Loonie gains more than 1 cent US after rate hike

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Stephen Poloz, governor of the Bank of Canada, speaks Wednesday to reporters in Ottawa about the rise of the bank's interest rates. (Fred Chartrand/Canadian Press)

The Bank of Canada has raised its key interest rate as expected to 0.75 per cent — the central bank's first move upward in the cost of borrowing in seven years.

The bank's target for the overnight rate — at which major financial institutions make one-day loans to each other — moved up by one-quarter of a percentage point from 0.50 per cent.

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In a statement accompanying the rate decision, the central bank said the Canadian economy has been robust, fuelled by household spending.

"As a result, a significant amount of economic slack has been absorbed," the bank said, adding that the remaining slack is expected to be gone around the end of this year, which is earlier than the bank anticipated in its April Monetary Policy Report.

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The move means consumers will likely pay more for borrowing such as variable-rate mortgages and lines of credit.

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# Rising Interest Rates

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In the wake of the rate hike, the Canadian dollar shot up. The loonie was up 1.05 cents at 78.48 cents US as of 4:33 p.m. ET on Wednesday. The daily average exchange rate for the Canadian dollar on Wednesday was 78.16 cents US, up 0.76 cents from Tuesday's average.

The interest rate increase had been widely expected after senior Bank of Canada officials signalled in speeches and interviews over the past weeks that lower rates had done their job, and the Canadian economy was performing well.

Speaking at a news conference on Wednesday in Ottawa, Bank of Canada governor Stephen Poloz acknowledged that the bank raised its key rate despite inflation currently lagging below its stated target of two per cent. Poloz said the bank considers that weakness in inflation to be temporary.

"It is worth remembering that it can take 18 to 24 months for a monetary policy action to have its full effect on inflation. This means that central banks must target future inflation by anticipating future deviations from target."

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Bank of Canada governor on rate hike 44:34

"It is about where we expect inflation to be," Poloz told reporters.

The bank is currently expecting a "modest overshoot" of the two per cent inflation target in 2019.

## More increases seen coming

RBC chief economist Craig Wright thinks the bank's move signals a turning point to a longer-term trend in rising interest rates.

"I think it's the Bank of Canada having confidence that the breadth and durability of the expansion in Canada can sustain these small increases in interest rates," Wright told CBC News Network.

"We're going to see more [rate hikes] as we move forward, assuming growth holds up," he said.

Sherry Cooper, chief economist at Dominion Lending Centres, said she expects another rate hike in the fourth quarter of this year.

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"The Federal Reserve will also likely increase rates in [the fourth quarter]," Cooper said in a release. "Look for a slow crawl upward in interest rates from both central banks in 2018."

The economy "can handle very well this move we have today and of course you need to preface that with an acknowledgment that of course interest rates are still very low," Poloz told reporters.

"People need to understand that in the full course of time I don't doubt that interest rates will move higher, but there's no predetermined path in mind at this stage."

Any future changes to the central bank's key interest rate will depend on economic data in the months ahead, he added.

The bank's next decision on interest rates is scheduled for Sept. 6.

## Performing well

The Bank of Canada hadn't increased the overnight rate since August 2010, when it nudged it up to one per cent. After Poloz took over as governor of the bank, the rate was lowered twice in 2015 to 0.5, where it remained until Wednesday.

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With the economy performing well, the bank has also nudged up its forecast for growth this year. The bank said real gross domestic product (GDP) is now expected to grow by 2.8 per cent in 2017, up from the April outlook of 2.6 per cent.

The central bank said growth is expected to moderate over the next two years, coming in at two per cent in 2018 and 1.6 per cent in 2019.

With files from The Canadian Press