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Canada

Bank of Canada Weighing Global Risks

- **Overnight rate remains at 1%, although uncertainty of global growth remains high**
- **Slight upward revision to 4Q11 will not offset growing global demand concerns**
- **Robust household spending remains a double-edged sword**

The Bank of Canada's (BoC) economic outlook remained consistent with the December interest rate release, with stable domestic demand, limited inflation concerns, but higher levels of uncertainty in regards to ongoing threats to European instability, commodity prices and slower emerging market demand. In addition, the Governing Council acknowledged that US growth was greater than anticipated in 2H11, but also maintained their belief that the US economy would return to a more modest growth trajectory in near term. Given the high degree of external uncertainty and near-term risks the committee reiterated their broad outlook and thus maintained the BoC overnight rate at 1%. On the domestic front, the committee expressed concern of accelerating debt-to-income ratios as households, rather than businesses, take advantage of the historically low rates. Moreover, commodity price fluctuations are generating both upside and downside risks as near-term geo-political risks — a potential Iranian embargo — increased the expectation of crude prices, while slowing global demand decrease expectations for metals and foods price suggesting ambiguity in the near-term price fluctuations.

While BoC acknowledged the recent performance of the Canadian economy, the Bank remains wary of the potential effects of a slowing international environment. Risks are balanced – both a tidy or untidy European resolution will trigger a new forecast for the overnight rate – but quarter-to-quarter fine tuning may occur. In particular, the effect of new Federal Reserve communication policies may or may not change market expectations of interest rate changes in the US, but BoC will need to evaluate this policy regime in order to avoid too large an interest rate differential with the US. However, we maintain our current forecast of a next rate increase in March of 2013.

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