



# Economic Flash!

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## ***Carney is a Man in No Hurry***

- Financial markets tend to get edgy sitting still, but Bank of Canada Governor Carney is a man in no hurry to act. Drawing a parallel with Australia, where a rate hike came earlier than expected, investors have recently been pushing up Canadian short-term yields in anticipation that Canada wouldn't be far behind. To those expecting an early rate hike in Canada, the Bank's message was "no so fast".
- In particular, the Bank takes currency impacts on growth and inflation very seriously. After citing a list of fresh positives – including better-than-expected global growth and improvements in financial market conditions – the Bank asserts that these will be "more than offset" by the drag from persistent Canadian dollar strength. That was consistent with what we noted in Friday's "Week Ahead," in terms of the considerable currency sensitivity of the Bank of Canada's forecasting model.
- For the near term, before the currency impacts have a chance to bite, the Bank has "slightly" raised its 2009 second half forecast. Hitting its -2.4% real GDP forecast for 2009 as a whole implies that the Bank's forecast for Q4 growth must now be close to 4%.
- But that firmer end to this year would tend to raise the annual growth rate for 2010 as a whole. Instead, the Bank has left that at 3.0%, implying that it has slightly lowered quarterly growth rates for the coming year to capture the hit to exports from a firmer currency. Growth of 3.3% in 2011 would bring the economy to its non-inflationary potential by Q3 2011, a quarter later than earlier projected. The prospect for returning CPI to the 2% target is similarly delayed to match that timing.
- While these adjustments are really only tinkering, given the uncertainties inherent in projecting growth a year or more ahead, they reinforce the Bank's pledge to keep interest rates on hold at least until after June of 2010. Since the timing of rate moves is geared to the timing of getting inflation back to the 2% target, if anything, the Bank might have added a few months to when it anticipates pulling the trigger on the first rate hike. Indeed, it still has risks to its forecast path for inflation tilted to the downside.

## **Implications & Actions**

- **Re: Economic Forecast** — While we are roughly in line with the Bank of Canada's growth projection over the balance of this year, we're not as optimistic about Canada's ability to shrug off a likely slowing in US growth in the first half of 2010, when the push from inventory restocking will fade. If our call is on the mark, it will take even longer than the Bank's forecast to get back to full employment and a zero output gap. If the Fed stays on hold on rates in 2010 (and sticks only to unwinding some of the quantitative easing), it will be difficult for the Bank of Canada to move ahead of it as long as the C\$ is within earshot of parity.

- **Re: Markets** — The market's reaction underscores that fixed income and foreign exchange markets are dancing together in an odd tango. When fixed income investors start to expect an earlier rate hike, the upward pressure on the currency's valuation makes such a move less likely. When rate expectations are becalmed, it helps the currency return to earth, as we saw today after the Bank's dovish talk.

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