BBVA Research Flash

Canada

Bank of Canada Prepares for a Rocky 2012

- **With slack to persist until 2013, rates will be on hold for longer**
- **Central bank's outlook is significantly less favorable than in July**
- **Growth forecast for 2012 revised downwards to 1.9%**

The Bank of Canada (BoC) today left the target for the overnight rate at 1%, but signaled strong worries on the course of economic growth for the next two years. According to the statement, the outlook is "significantly less favorable" than BoC's forecast in July, stemming from strains in financial, confidence and trade channels. In particular, BoC now expects Europe to experience a mild recession, although any crisis-like events will be contained. While in July BoC expected 2.6% growth for 2012, it now expects 1.9% growth and now forecasts that the economy will reach capacity only by the end of 2013. As a result of these effects combined with less enthusiastic growth in emerging markets and the US, BoC revised down their path for inflation to trough at 1.0% in the middle of 2012. Core inflation will decline in 2012 and return to 2.0% by the end of 2013.

Tomorrow's Monetary Policy Report will reveal more insight into BoC's expectations for inflation based on their forecast for oil in 2012. With regard to growth, our sense has always been fairly pessimistic for Canada given subdued growth in the US (although the timing of these effects on Canadian growth has been different than we expected). We previously foresaw a lower US GDP forecast as a wrinkle in BoC's July forecast. The tone of the announcement is that of a central bank preparing for a very rocky 2012, which is a strong contrast with the last rate announcement. The slower elimination of resource slack in the economy combined with downward pressures on inflation suggest that BoC will be on hold for longer than our current forecast and the next rate increase will likely be in 2013.

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