BBVA Research Flash

Canada

Bank of Canada Focused on Europe

- **Overnight rate remains at 1%, with “more pronounced” European recession**
- **Stronger-than-expected 2011Q3 growth cannot fully counterbalance external risks**
- **Hints at slightly higher inflation forecast, but overall theme of softening remains**

Since October, Canada’s GDP and inflation arrived higher than expected by the Bank of Canada (BoC). This is only slightly the case for inflation, since only one month’s worth of the quarter has arrived so far and it has suggested an aggressive start to 2011Q4 relative to BoC’s expectation. On the other hand, GDP for 2011Q3 is significantly higher than BoC’s forecast. These two trends, however, are clearly secondary to BoC’s concerns regarding the effect of European fiscal issues on external demand for Canadian exports. This makes sense given the potential of a disorderly European conclusion to hijack all internal Canadian momentum from consumption and investment. With a stable domestic banking system and a watchful eye on housing and household spending, BoC’s rate announcement today continues its laser-like focus on conditions in Europe. Given no substantive changes to this problem in the near future, the Bank’s sentiments today do not change our expectation of a next rate hike in March of 2013. A sudden resolution or abrupt worsening of European fiscal woes will trigger changes to BoC’s policy stance.

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