BBVA Research Flash

Canada

Monetary Policy Report January 2012

- **Global economy weighs on committee outlook**
- **Inflation to pick up in 2012 as WTI spot prices increase via geopolitical risk**
- **Growth forecasts remain in line with October 2011 MPR**

In the January release of the Bank of Canada's (BoC) Monetary Policy Report (MPR), the Governing Council maintained their cautious optimism and suggested that global downside risks remained, although largely by indirect channels. A point of emphasis in today's MPR was the continued weakness in global demand, which is likely to persist. The global resource slack, once thought to be compensated for by global rebalancing and emerging market demand is not expected to offset the negative headwinds in Euro area, financial uncertainty, household deleveraging in the US and fiscal austerity. As such, the baseline scenario for the US and Canada has been revised down slightly to incorporate what we believe to be a more realistic outlook for 2012 and 2013. Nevertheless, strong Canadian household consumption should positively influence domestic growth over the forecast horizon (2012-2013).

For example, growth forecasts for the US and Canada were revised up slightly in 2011 and 2012 respectively. This 2011 figures reflect the stronger than anticipated growth in 4Q11 while also incorporating more favorable North American financial conditions in 2012— although financial volatility has remained high following the October report. The downward revision to 2013, however, is largely a reflective of the changing global environment, which includes slowed global demand and fiscal austerity. Their baseline scenario incorporates a 2.2% US GDP growth rate in 2013. Unlike the downward revision to domestic consumption, the council's outlook on housing improved after auspicious loan officer survey reports and substantial credit availability and is expected to increase growth by 0.2pp on average.

The slow growth environment is reflected in the council's inflation expectations and forecast, as core and headline inflation converge to 1.7% QoQ a rate in 4Q12. The convergence is the result of two factors. First, is the normalization of the headline inflation rate following the HST tax. Secondly, the council increased its West Texas Intermediate (WTI) crude oil forecast from average $88 per barrel to $100 per barrel, from 1Q12 through 4Q13, incorporating heightened geopolitical risk. In addition, the inflation forecasts incorporate slowed commodity price growth in metals, food, and non-crude energy products. Nonetheless, non-commodity price risks remain. Upside risks include global demand pressures, increased US consumption, decreased US austerity impact and accelerated housing expenditures; downside risks include Canadian household deleveraging and European spillover into global markets.

In total, the Monetary Policy report upheld the previous view of a modest growth and stable inflation for 2012 and 2013. Although the European situation looms large, the council felt downside risks were largely indirect, and highlighted the coordinated efforts of central banks to ease global credit constraints and assuage equity market uncertainty. As such, the committee maintained the overnight rate at 1%, and suggested that conditions would remain favorable to households and business in the short to medium term.

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