Canada Flash

Bank of Canada(BoC) says "[w]ithdrawal of considerable monetary stimulus may be appropriate"

In today's release, the BoC's phrasing pulled forward expectations of the next interest rate increase, possibly indicating a hawkish tipping point for the Bank. Robust internal demand, firming inflation, and diminished external risks were reasons for the improved expectations and subsequent change in communication. Nevertheless, we anticipate the bank will adjust its benchmark rate of 1.0% in April of 2013. There is a notable risk of an earlier rate hike than our forecast if external headwinds diminish and the US and Europe post stronger economic health.

- **Pace is "firmer than the bank expected" with 2.4% growth in 2012 and 2013**

  The revised expectations are largely attributable to strong domestic demand, which the Bank indicated will account for nearly all of Canada's economic growth, and decreased external risks. In previous communications the BoC stressed the sound internal growth factors but discounted the external headwinds in the United States and Europe. Now, as the US labor market conditions improve and downside risk to Europe and emerging markets decline, the bank feels demand is sufficient to maintain growth of 2.4% in 2012 and 2013. However, in crude oil markets, there appears to be market inefficiencies as domestic producers are unable to capture price increases in world markets, posing a downside risk.

- **Inflation firms; forecasted to cool to mandated levels**

  The uptick in gasoline prices and decreased slack are generating slightly higher inflation; although the BoC is expecting inflation to moderate over the quarter. In assuming slightly moderating inflation in 1Q12, it is likely the bank is incorporating the level effects that will likely pull-down March consumer price inflation. In addition, long-run inflation expectations are "well-anchored".

- **Monetary Policy Report should fill-in the margins of today's statement**

  Today's communication from the BoC indicated that there is impetus to consider modest withdrawal from the considerable monetary stimulus. This hawkish shift could suggest to some a more immediate interest rate increase. However, the language and fact that the Bank articulated that slack still remained in the economy, suggest adjustments are not imminent. Furthermore, tomorrow's Monetary Policy Report (MPR) will provide more detailed forecasts which should improve expectation formulation with regard to Canadian interest rates. From this perspective, the BoC's sentiments regarding the outlook for inflation and the output gap will be important for timing the next rate hike.

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