

Bank of Canada: O/N rate unchanged

Statement tweaked - slightly softer tone

No surprise in that the BoC left its overnight rate unchanged at 1.00%. The post meeting statement gets some tweaking with a slightly softer tone than was the case with the October meeting but really only on the margins.

The Facts.

Changes to the BoC story came in the form of the increased risk associated with the European sovereign debt crisis and the potential to "trigger renewed strains in global financial markets". This constitutes the slightly softer story out of the Bank along with the acknowledgment that net trade was an albatross on growth in Q3. On the upside, business investment was characterized as robust and household spending was stronger than expected.

Implications.

Little. The story changed on the margins. From the standpoint of the European sovereign crisis and potential impact on markets, well that is an event that is measurable in real time. At present, for Canada, the impact has largely been in terms of the rising status of Canada as a safe haven currency which arguably aggravates the BoC view to net trade and its "previously identified risk that a combination of disappointing productivity performance and persistent strength in the Canadian dollar could dampen the expected recovery in net exports". True, but there is little that policy can do about that. And indeed many will be inclined to view the disappointment attached to Q3 GDP and net trade and suggest that this sets the bar to a rate increase higher.

Alternatively, we choose to take into consideration the fact that stronger than expected household spending is coming on the back of higher consumer debt loads that if left unfettered, risk consumer imbalance. But don't blame the consumer for following the pricing signals they are provided for by the pricing of money in the current low rate environment. And it is important to remember that Canada has a fully functioning banking system. Whereas many financials in other developed world monetary jurisdictions have been working down their balance sheets, Canadian banks have been toiling away at working theirs up. Year over year, total chartered bank assets are up 4.5% led by mortgage lending up over 8%/y, credit card debt up 5.5% and personal lines of credit up a whopping 9.7%. On the other side of the ledger is the consumer that is driving debt to disposable income to new historical highs on a quarterly basis.

The bottom line.

Horns of a dilemma. Does the BoC risk consumer imbalance and focus on shielding exporters from further dollar strength at the hands of tighter policy or risk hiking rates in 2011 as a means of deterring the consumer binge on cheap credit and potentially sacrificing export growth. Our focus is on consumer behavior and its longer term implications for household imbalance given the current rate profile. In that, our view to a 25bp rate hike at the March meeting remains intact.

Although January's beefier post meeting statement and release of their monetary policy report that will flesh out its economic base case will provide greater clarity as to the Bank's intentions going into 2011.

Disclosure appendix

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