

# Bank of Canada leaves overnight rate target at 1.00%

## Outlook softens, output gap widens slightly

**The Bank of Canada left rates unchanged, as was widely expected, at the scheduled rate meeting on 19 October. The action reflected rare unanimity. A Reuters survey reflected that all 41 participants looked for no change in the BoC overnight target rate. We also had expected no change.**

The decision for a pause in the rate cycle was driven by deceleration in the rate of the economic recovery, which has been reflected in reductions of BoC growth forecasts for 2010, shaved by 0.5ppt to 3.0%, and for 2011, trimmed by 0.6ppt to 2.3%. The increasingly uncertain economic environment also is exacerbated by "heightened tensions in currency markets and related risks associated with global imbalances," [the central bank said in its statement]. On the upside, 2012 GDP forecasts have been nudged higher by 0.4ppt to 2.6%.

For Canada, inflation has been tracking below plan; the BoC is a single-mandate bank, which targets a 2.0% inflation rate. And on this front, the BoC has opened up some considerable elbow room for itself on monetary policy, with its move to push back the expected point at which the output gap will close, to the end of 2012 from the July forecast for the beginning of 2012. So too has the BoC accepted that the inventory surge associated with robust growth rates seen for Q409 and Q110 has largely run its course, to be replaced by fiscal austerity and moderate rates of growth for private demand. The BoC continues to look for a necessary rollover in domestic demand, from consumer and fiscal sources, to business and net trade.

In broad terms, we expect the Canadian economy to continue along the road to recovery, although growth rates should be incremental, in keeping with the overall tone and tenor of the developed-world economic environment. It is further complicated by a Canadian consumer that is running historically high levels of debt, as measured by total household debt-to-disposable income, which jumped from 130% in Q108 to 146% in Q110. Our concern is that consumers have borrowed based on the cost of carry, rather than worrying about the aggregate amount of debt that they have been accumulating, leaving Canada with a consumer debt problem of its own if left unchecked. For the BoC, some comfort may be drawn from some moderation in the real estate market, as had been expected.

Our forecast looks for the BoC to remain sidelined until March 2011. As this is based on incremental rates of growth only for the Canadian economy, we believe that it is not necessarily out of context with the BoC statement. We forecast Canadian GDP will grow 3.0% in 2010 and 2.1% in 2011.

More to come on Thursday, 21 October, with the release of the Monetary Policy Report.

# Disclosure appendix

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