

Hike rates, stand still; hike rates, stand still; and repeat

Bank of Canada hikes rates 25bps, delivers opaque statement.

The Bank of Canada hiked rates by 25bps today as was widely expected by forecasters, taking the overnight target to 1.00%. This is the third consecutive rate hike since the Bank restarted the rate cycle in June of this year. Market capital however was a little less certain over the potential for a rate hike in the immediate run up to today's meeting, precipitating some necessary re-pricing in the front end of the curve on the back of the rate announcement.

And while the rate hike was followed up with a post meeting statement that is rather opaque in its outlook - in keeping with the past precedents at the BoC - its tone and texture is cutting across terrain less dovish than would have likely been anticipated by market participants. To be quite clear, this is not a hawkish statement in the conventional sense, yet its tone is considerably firmer than may have been anticipated. So too is its texture more buoyant in places than was likely expected. In turn, the post meeting statement to some extent challenges the market view that today's meeting would mark the Bank's "one and done" finale before pausing the cycle.

Our own forecast has been to look for rate hikes at each of the remaining two BoC rate meetings for this year. A lonely existence to be sure. Yet it is a view that is not inconsistent with the upbeat picture on domestic demand painted by today's post meeting statement. A statement that reflects the Bank's inclination to keep all its doors and options open including continued rate hikes.

To wit, the BoC concludes its statement with the view that "any further reduction in monetary policy stimulus would need to be carefully considered in light of the unusual uncertainty surrounding the outlook." Not that far removed from the last meeting statement suggested that "given the considerable uncertainty surrounding the outlook that any further reduction in monetary stimulus would have to be weighed carefully".

Interesting nuances in the language but no wholesale gravitation in sentiment. Front and centre, it reflects the fact that further rate hikes have not been taken off the table given the very mention of "any further reduction in monetary stimulus". And while we live in uncertain times, it is hard to ignore the heightened uncertainty generated by events in the US since the last rate meeting and yet the BoC made the decision to hike rates again.

A balance of factors.

Yes short rates have risen on the back of BoC rate hikes, but at the same time long rates have collapsed. The BoC suggests that "as a result of monetary policy measures taken since April, financial conditions in Canada have tightened modestly but remain exceptionally stimulative". Exceptionally stimulative. It seems that the uncertainty generated by an uncertain future has tended to cloud the fact that rates policy in Canada remains extraordinarily accommodative at the same time the market pricing has been easing credit conditions.

Since the BoC telegraphed its intent to restart the rate cycle at the April 2010 meeting, and preceded to raise rates by 75bps, 10-year yields in Canada have collapsed by 80bps. And of course let's not forget that USD/CAD has moved into a higher

trading range since April, affording some support to exporters. In one sense, the BoC has been running hard on policy just stand still.

And while there is an increased drag associated with US private demand being held back by high unemployment and an increasingly muted recovery in the US in the "near term" (policy is set in the medium), in Canada consumption growth is expected to remain solid and business investment to rise strongly. All of which is expected to be supported by accommodative credit conditions. A rather buoyant reappraisal.

Recall that in July's post meeting statement, "business investment appears to be held back by global uncertainties and has yet to recover from its sharp contraction..." Q2's GDP report - a part from the disappointment associated with the headline reading - reflected a sharp snap back in business demand for plants and equipment that would have been a welcome sight to the BoC and provide a nice offset to the uneven nature of the US economic recovery. Of course there is also the offset of weak developed world growth provided by strong activity in the emerging markets economies.

And despite this rather uncertain environment, the recovery profile for the Canadian economy according to the BoC is expected to be only "slightly more gradual" than projected in July due to events in the US. And of course as a single mandate bank (price stability), the statement that "inflation in Canada has been broadly in line with the Bank's expectations and its dynamics are essentially unchanged" tends to suggest that the BoC is holding to its July economic base case (atleast for now) that looks for the output gap to close by the end of 2011.

Given that the drag on Canada is associated with a weaker profile for US activity, it would seem that a primary driver of sentiment as it pertains to BoC rate policy is going to be how the US data stream evolves or rather potentially devolves between now and the next BoC rate meeting on October 19th. As has been the case throughout this whole process, the unfolding rate cycle in Canada is on a meeting by meeting basis. Uncertainty indeed.

Disclosure appendix

Analyst certification

The following analyst(s), who is(are) primarily responsible for this document, certifies(y) that the opinion(s), views or forecasts expressed herein accurately reflect their personal view(s) and that no part of their compensation was, is or will be directly or indirectly related to the specific recommendation(s) or views contained in this research report: Stewart Hall

This document has been prepared and is being distributed by the Research Department of HSBC and is intended solely for the clients of HSBC and is not for publication to other persons, whether through the press or by other means.

This document does not provide individually tailored investment advice and should not be construed as an offer or the solicitation of an offer to buy or sell any securities or to participate in any trading strategy. The information contained within this document is believed to be reliable but we do not guarantee its completeness or accuracy. Any opinions expressed herein are subject to change without notice. HSBC may hold a position in, buy or sell on a principal basis or act as a market maker in any financial instrument discussed herein.

Analyst(s) are paid in part by reference to the profitability of HSBC which includes investment banking revenues.

HSBC has procedures in place to identify and manage any potential conflicts of interest that arise in connection with its Research business. HSBC's analysts and its other staff who are involved in the preparation and dissemination of Research operate and have a management reporting line independent of HSBC's Investment Banking business. Chinese Wall procedures are in place between the Investment Banking and Research businesses to ensure that any confidential and/or price sensitive information is handled in an appropriate manner.

Additional disclosures

- 1 This report is dated as at 08 September 2010.
- 2 All market data included in this report are dated as at close 08 September 2010, unless otherwise indicated in the report.
- 3 HSBC has procedures in place to identify and manage any potential conflicts of interest that arise in connection with its Research business. HSBC's analysts and its other staff who are involved in the preparation and dissemination of Research operate and have a management reporting line independent of HSBC's Investment Banking business. Information Barrier procedures are in place between the Investment Banking and Research businesses to ensure that any confidential and/or price sensitive information is handled in an appropriate manner.

Disclaimer

** Legal entities as at 31 January 2010*

'UAE' HSBC Bank Middle East Limited, Dubai; 'HK' The Hongkong and Shanghai Banking Corporation Limited, Hong Kong; 'TW' HSBC Securities (Taiwan) Corporation Limited; 'CA' HSBC Securities (Canada) Inc, Toronto; HSBC Bank, Paris branch; HSBC France; 'DE' HSBC Trinkaus & Burkhardt AG, Dusseldorf; 000 HSBC Bank (RR), Moscow; 'IN' HSBC Securities and Capital Markets (India) Private Limited, Mumbai; 'JP' HSBC Securities (Japan) Limited, Tokyo; 'EG' HSBC Securities Egypt S.A.E., Cairo; 'CN' HSBC Investment Bank Asia Limited, Beijing Representative Office; The Hongkong and Shanghai Banking Corporation Limited, Singapore branch; The Hongkong and Shanghai Banking Corporation Limited, Seoul Securities Branch; The Hongkong and Shanghai Banking Corporation Limited, Seoul Branch; HSBC Securities (South Africa) (Pty) Ltd, Johannesburg; 'GR' HSBC Pantelakis Securities S.A., Athens; HSBC Bank plc, London, Madrid, Milan, Stockholm, Tel Aviv, 'US' HSBC Securities (USA) Inc, New York; HSBC Yatirim Menkul Degerler A.S., Istanbul; HSBC México, S.A., Institución de Banca Múltiple, Grupo Financiero HSBC, HSBC Bank Brasil S.A. - Banco Múltiple, HSBC Bank Australia Limited, HSBC Bank Argentina S.A., HSBC Saudi Arabia Limited.

Issuer of report

HSBC Securities (Canada) Inc.
70 York Street, 8th Floor
Toronto, Ontario M5J 1S9, Canada
Telephone +1 416 868 7523
Fax +1 416 364 2543
Website: www.research.hsbc.com

This document has been issued by HSBC Bank Canada, HSBC Securities (Canada) Inc., and/or their affiliates (collectively "HSBC"). The material contained in this document is for the information of clients of HSBC and is not for publication to other persons, whether through the press or by other means. Unless otherwise stated, any pricing information given in this document is indicative only, is subject to change and does not constitute an offer to buy or sell any securities, currency or related financial instrument at any price quoted. HSBC is not liable for any errors or omissions in the content or transmission of this email. Where this document contains market updates/overviews, or similar materials (collectively deemed "Commentary" in Canada although other affiliate jurisdictions may term "Commentary" as either "macro-research" or "research"), the Commentary is not an offer to sell, or a solicitation of an offer to sell or subscribe for, any currency or related instrument. No consideration has been given to the particular investment objectives, financial situation or particular needs of any recipient in the preparation of the Commentary. The Commentary is derived from sources HSBC believes to be reliable but which HSBC has not independently verified. No representation or warranty is made with respect to the completeness or accuracy of the Commentary. HSBC, its affiliates, their directors, officers, employees and agents: (1) are not liable for any direct or consequential loss arising from use of or reliance on the Commentary, and (2) may have a long or short position in, or otherwise participate in markets for, the currencies and securities mentioned in the Commentary.

This document may be distributed in the United States solely to "Major US Institutional Investors" (as defined in Rule 15a-6 of the US Securities Exchange Act of 1934); such recipients should note that any transactions effected on their behalf will be undertaken through HSBC Securities (USA) Inc. in the United States. In Singapore, this publication is distributed by The Hongkong and Shanghai Banking Corporation Limited, Singapore Branch for the general information of institutional investors or other persons specified in Sections 274 and 304 of the Securities and Futures Act (Chapter 289) ("SFA") and accredited investors and other persons in accordance with the conditions specified in Sections 275 and 305 of the SFA. This publication is not a prospectus as defined in the SFA. It may not be further distributed in whole or in part for any purpose. The Hongkong and Shanghai Banking Corporation Limited Singapore Branch is regulated by the Monetary Authority of Singapore. Recipients in Singapore should contact a "Hongkong and Shanghai Banking Corporation Limited, Singapore Branch" representative in respect of any matters arising from, or in connection with this report. In Hong Kong, this document has been distributed by The Hongkong and Shanghai Banking Corporation Limited in the conduct of its Hong Kong regulated business for the information of its institutional and professional customers; it is not intended for and should not be distributed to retail customers in Hong Kong. The Hongkong and Shanghai Banking Corporation Limited makes no representations that the products or services mentioned in this document are available to persons in Hong Kong or are necessarily suitable for any particular person or appropriate in accordance with local law. All inquiries by such recipients must be directed to The Hongkong and Shanghai Banking Corporation Limited. In Korea, this publication is distributed by either The Hongkong and Shanghai Banking Corporation Limited, Seoul Securities Branch ("HBAP SLS") or The Hongkong and Shanghai Banking Corporation Limited, Seoul Branch ("HBAP SEL") for the general information of professional investors specified in Article 9 of the Financial Investment Services and Capital Markets Act ("FSCMA"). This publication is not a prospectus as defined in the FSCMA. It may not be further distributed in whole or in part for any purpose. Both HBAP SLS and HBAP SEL are regulated by the Financial Services Commission and the Financial Supervisory Service of Korea. In the UK this report may only be distributed to persons of a kind described in Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2001. The protections afforded by the UK regulatory regime are available only to those dealing with a representative of HSBC Bank plc in the UK. HSBC México, S.A., Institución de Banca Múltiple, Grupo Financiero HSBC is authorized and regulated by Secretaría de Hacienda y Crédito Público and Comisión Nacional Bancaria y de Valores (CNBV). HSBC Bank (Panama) S.A. is regulated by Superintendencia de Bancos de Panama. Banco HSBC Honduras S.A. is regulated by Comisión Nacional de Bancos y Seguros (CNBS). Banco HSBC Salvadoreño, S.A. is regulated by Superintendencia del Sistema Financiero (SSF). HSBC Colombia S.A. is regulated by Superintendencia Financiera de Colombia. Banco HSBC Costa Rica S.A. is supervised by Superintendencia General de Entidades Financieras (SUGEF). Banistmo Nicaragua, S.A. is authorized and regulated by Superintendencia de Bancos y de Otras Instituciones Financieras (SIBOIF). In Australia, this publication has been distributed by The Hongkong and Shanghai Banking Corporation Limited (ABN 65 117 925 970, AFSL 301737) for the general information of its "wholesale" customers (as defined in the Corporations Act 2001). Where distributed to retail customers, this research is distributed by HSBC Bank Australia Limited (AFSL No. 232595). These respective entities make no representations that the products or services mentioned in this document are available to persons in Australia or are necessarily suitable for any particular person or appropriate in accordance with local law. No consideration has been given to the particular investment objectives, financial situation or particular needs of any recipient. All rights reserved. No part of this publication may be reproduced, stored in a retrieval system, or transmitted, on any form or by any means, electronic, mechanical, photocopying, recording, or otherwise, without the prior written permission of HSBC Securities (Canada) Inc. HSBC Securities (Canada) Inc. is a wholly owned subsidiary of, but separate entity from, HSBC Bank Canada. Member CIPF. ©Copyright 2010. MICA (P) 142/06/2010 and MICA (P) 193/04/2010