



Economy hotter than estimated, Bank of Canada says

Jeremy Torobin Ottawa — Globe and Mail, Mar. 02, 2010

The Bank of Canada kept its benchmark lending rate at a historic low 0.25 per cent Tuesday, while hinting that policy makers are on closer guard for shifts in the inflation outlook that might force them to rethink their pledge to stay on hold through midyear.

In the statement accompanying Tuesday's decision, Governor Mark Carney and his rate-setting panel acknowledged that growth and inflation have been hotter than policy makers projected in their January forecast, saying the economy's 5-per-cent growth in the fourth quarter was "spurred by vigorous domestic spending and further recovery in exports."

Also, in a nod to the fact core inflation came in at the central bank's 2-per-cent target in January, sooner than policy makers had anticipated, they sounded a somewhat more hawkish tone on price gains. The central bank said the risks to their inflation outlook are now "roughly balanced," as opposed to language from previous statements which had said inflation risks were "tilted slightly to the downside."

The bank also added the word "current" in its key sentence reiterating Mr. Carney's commitment to keep borrowing costs at their record-low level, suggesting the next decision on April 20 could mark the beginning of the end of easy money as the central bank prepares to lay out how it plans to tighten in the second half of the year.

While few economists expect Mr. Carney to raise interest rates before that commitment runs out, recent data and the current statement suggest there is more pressure on the bank to consider unleashing a series of rate hikes over several decisions starting in July, or raise rates more steeply than the typical 25-basis point moves.

"Carney and Co. are starting to feel the urge to tighten, not a strong urge now, but an urge nevertheless," Michael Gregory, a senior economist with BMO Capital Markets, said in a note to clients. "We still judge that the Bank will hike rates 25 basis points on July 20, with rising risks that this and/or subsequent moves could be in larger increments."

Core inflation has been "slightly firmer" than expected, the bank said, as a result of "both transitory factors and the higher level of economic activity." The reference to "transitory factors" likely refers to recent gains in prices for automobiles such as trucks, which don't seem sustainable, and housing prices.