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Bank of Canada expected to hike then pause on rates

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Bank of Canada Governor Mark Carney will probably raise borrowing costs today for a third and final time this year before pausing to gauge the strength of the economic recovery, economists said.

Fourteen of 20 economists surveyed by Bloomberg News expect Mr. Carney to raise the bank's policy interest rate by a quarter point to 1% in a decision to be released at 9 a.m. ET. Economists forecast Mr. Carney will keep the rate at that level until April, according to a separate survey.

Policy makers may be unwilling to tighten policy further as Canada's economy expanded more slowly than anticipated in the second quarter, and as the U.S. proposes additional stimulus amid signs of renewed weakness. Mr. Carney may also signal greater risks to its projections from weakness outside Canada.

"The bank will position itself for a slower growth scenario," said Marc Rouleau, a fund manager at Standard Life Investments in Montreal who helps manage $18-billion in fixed-income assets.

The bank's June 1 increase, which was followed by another on July 20, was the first among Group of Seven countries after last year's global recession. Canada has recovered from the slump faster than the U.S., having already returned to pre- recession levels of employment. Carney has said the current 0.75% rate still provides "considerable monetary stimulus."

The bank has also warned the risks to its projections are elevated, and that future rate increases are not "pre- ordained." Last month, diminishing prospects for U.S. growth sent global stocks tumbling and prompted the Federal Reserve to signal the possibility of adding monetary stimulus.

Canadian investors have pared bets over the past month that Mr. Carney will increase lending rates. The yield on December 2010 bankers' acceptances contract, the most actively traded contract, has fallen to 1.14%, from 1.29% a month ago and a 2010-high of 2.02% on April 21. The contracts have settled an average of about 20 basis points above the central bank's overnight target since 1992, Bloomberg data show.

The Canadian economy, after growing at an annualized 5.8% pace in the first quarter, slowed in the April-June period to a 2% rate -- a full percentage point below the central bank's prediction. As well, employers cut workers in July for the first time this year and the core rate of inflation, which is closely watched by the bank, unexpectedly slowed to 1.6% in July.

Canada "remains on sounder footing than the U.S., but all eyes are focused on U.S.," said Anil Tahiliani, a fund manager at McLean & Partners Wealth Management in Calgary, Alberta, in an e-mail. "We expect after this small increase of 0.25%, the BOC will go on hold since the economy is starting to slow and global economic concerns take front stage."

Earnings for Standard & Poor's/TSX Composite Index companies that have released results since July 12 have dropped 4.3% from a year ago, pulled down by Manulife Financial Corp., Canada's largest insurer, which on Aug. 5 reported a $2.4-billion loss that was more than double forecasts.

U.S. President Barack Obama is proposing to expand tax relief for businesses and boost federal spending on transportation to help bolster the economy. In Milwaukee on Sept. 6, Obama called for US$50-billion in the first of a six-year program to fix roads and railways.

The U.S. Federal Reserve moved Aug. 10 to shore up the recovery, deciding to reinvest principal payments on mortgage assets it holds into long-term Treasuries. Policy makers put a US$2.05-trillion floor on the Fed's securities holdings to prevent money from draining out of the financial system.

Fed Chairman Ben S. Bernanke said in an Aug. 27 speech that while the "preconditions" for stronger growth year are in place, the Fed was prepared to embark on more stimulus, such as asset purchases, if needed.

Mr. Carney may want to avoid providing too much direction to investors given uncertainty over the economic outlook, said Eric Lascelles, chief economics and rates strategist with Toronto-Dominion Bank. Canada's GDP report showed domestic demand remains buoyant, led by investments from businesses such as Potash Corp. of Saskatchewan Inc. and Suncor Energy Inc.

"I don't think this is the sort of thing where the market is going to come out and say, 'Well, they are pausing with absolute certainty in October,'" said Mr. Lascelles, chief economics and rates strategist with Toronto-Dominion. "I suspect the bank does want to keep those options open."