

Carney hikes rates, cites uncertainty

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Ottawa — Bank of Canada Governor Mark Carney raised his benchmark interest rate for the third straight time Wednesday, but left himself room to pause at his next scheduled decision by saying that while borrowing conditions in Canada remain “exceptionally stimulative,” the overall economic climate is fraught with “unusual uncertainty.”

In the statements on his decision to lift the overnight rate by another quarter of a percentage point to 1 per cent, Mr. Carney reiterated - arguably more strongly than in the past - that future moves will depend on developments around the world and, in turn, how they are affecting Canada's export-heavy economy.

“Any further reduction in monetary stimulus would need to be carefully considered in light of the unusual uncertainty surrounding the outlook,” the central bank said, tweaking language in the all-important last line of the statement, which in the two previous versions referred to “considerable” uncertainty.

Unlike those earlier statements, on June 1 and July 20, Wednesday's decision included no mention of debt problems or belt-tightening in Europe. However, Mr. Carney left little doubt that the sputtering U.S. recovery is now the No. 1 risk to the global and Canadian recoveries, saying in the second paragraph of his statement that the rebound in private demand south of the border is being crimped by stubbornly high joblessness and that “recent indicators suggest a more a more muted recovery in the near term.”

As a result, the central bank said, the global bounce-back from the worst downturn since the Depression is “proceeding but remains uneven, balancing strong activity in emerging market economies” (such as China and India, though the central bank didn't name them) against “weak growth in some advanced economies.”

At the same time, the central bank appeared to downplay the effect that the global turmoil is having on Canada, calling the country's 2-per-cent annual growth rate in the second quarter “slightly softer” than what policy makers had expected, even though their latest forecast in July was for a 3-per-cent pace.

The Canadian recovery will be “slightly more gradual” than the central bank expected in July, but consumer spending and investment have “evolved largely as anticipated,” it said, reflecting the fact Mr. Carney's forecasts have warned of a slowdown for several months because of factors such as the fading impact of government stimulus and the cooler real-estate market.

In the future, consumption growth will “remain solid” and business investment -- which had a surprisingly strong pickup in the second quarter, Statistics Canada data last week showed -- will “rise strongly,” the central bank said. For now, as the U.S. recovery proceeds in fits and starts, investor demand for safer investments such as bonds is pushing borrowing costs down and helping consumers and companies, the bank noted.

“Financial conditions in Canada have tightened modestly but remain exceptionally stimulative,” the central bank said. Policy makers also said dynamics affecting inflation in the country -- which has been tame for months -- are “essentially unchanged” from their July forecast.

All of that suggests Mr. Carney and his deputies are still uncomfortable with an overnight lending rate so far away from what most economists consider “neutral,” or about 3.5 per cent to 4 per cent. Indeed,

some analysts interpreted Mr. Carney's tone on the Canadian economy as a sign he still leans towards raising rates.

“The Bank of Canada clearly retains its tightening bias, and seems generally unfazed by the recent cooling in the Canadian economy,” Doug Porter, deputy chief economist at BMO Nesbitt Burns, said in a note to clients. “It appears that it will take a deeper slowdown in domestic spending (and core inflation) than what we have seen so far to prompt them to stop raising rates.”

Still, the continuing emphasis on risks from abroad and on the uncertain nature of the global recovery indicate policy makers want to remind investors that the central bank reserves the right to pause at its next decision, on Oct. 19, to spend more time assessing how the situation in Canada and abroad is unfolding. Mr. Carney, who is the only Group of Seven central banker to raise rates this year, would explain such a move in a new forecast the following day.

Other economists, such as Jonathan Basile of Credit Suisse, noted the similarity between the last line of the statement and a comment made by Federal Reserve chairman Ben Bernanke in July as the U.S. turnaround was starting to hit a wall, when he told lawmakers in Washington the outlook was “unusually uncertain.”

Mr. Carney took a word “out of Bernanke’s playbook,” Mr. Basile said, and the new wording “can be interpreted as worse” than in past Canadian statements.

Central bankers in Japan and Australia this week indicated that fears about the durability of the U.S. rebound are weighing heavily even on the minds of policy makers whose countries aren’t quite as dependent on the world’s biggest economy. The Reserve Bank of Australia kept a pause in place on Tuesday, despite having the biggest spike in economic growth in the country since 2007, and the Bank of Japan highlighted “uncertainty” about the U.S. in saying that it is prepared to add more stimulus if needed.