

What to expect from Bank of Canada

OTTAWA -- Bank of Canada governor Mark Carney returns to the spotlight this week as he unveils the central bank's latest interest-rate decision -- another increase is expected -- and economic outlook. He'll also appear before Ottawa journalists Thursday to offer his view in his own words on the outlook on the economy, and whether it is headed for a dreaded double-dip as some have feared. Here's a rundown of the key things to watch for this week from the Bank of Canada.

What is likely to happen to rates?

The Bank of Canada is widely expected Tuesday to raise its benchmark interest rate by 25 basis points, to 0.75%, as Canadian economic data -- especially on the jobs front -- remain relatively robust. Core inflation, which removes volatile items, remains close to the central bank's 2% target. And indications are Canada's economic growth, the best by far among Group of Seven countries, is beginning to chip away at the spare capacity the recession created. In all, analysts argue there is no need for the central bank to keep its key policy rate at emergency-like levels.

There are those, led by academics who sit on the C.D. Howe Institute's monetary policy council, who suggest a 50-basis-point hike is required in an effort to get the policy rate back to a sustainable level before inflationary pressure builds. Meanwhile, analysts such as Brian Bethune of IHS Global Insight believe the Bank of Canada should hold off on rate hikes due to the increased risk of a "synchronized slowdown" among industrialized economies -- notably the United States and Europe.

What the Bank of Canada statement is likely to say?

Expect the central bank statement to mimic the pattern followed when it last raised rates on June 1 -- namely, hawkish action followed by dovish language. This gives Mark Carney, the Bank of Canada, enough flexibility to keep markets guessing, plus allow him to shift gears on a moment's notice should the global economy deteriorate.

"This hawkish action/dovish language tag-teaming will keep markets on their heels, with the effect that although the market will usually gravitate towards the belief that the next decision

will be a hike, it will remain slightly queasy about this assumption, and distinctly uncomfortable about later prospects,” said Eric Lascelles, chief Canadian strategist at TD Securities.

Further, this statement will provide a sneak peak of the Bank of Canada’s latest economic outlook, to be published Thursday. It is possible the central bank scales back its growth forecasts for the Canadian economy, given the set of weak data emerging from the United States and elsewhere. Previously, the central bank expected 3.7% expansion this year and 3.1% in 2011. There should be little mention of the Canadian dollar, as it has traded at roughly the mid-US90c range over the past two months.

What about interest rates for the rest of 2010 and 12 months out?

This is where opinions differ sharply, and that is best illustrated in the latest recommendations from the C.D. Howe Institute’s monetary policy committee -- which sort of acts like a shadow central bank. Council members believe a series of overnight rate increases over the coming year are necessary, as the output gap narrows and an emergency approach become less appropriate. However, the pace at which rates increase is up for debate.

Some Bay Street economists on the council lean toward just two more rate hikes, at 25-basis-point apiece, for the remainder of 2010. One of those analysts, Avery Shenfeld of CIBC World Markets, said the central bank would hike its benchmark rate to 1.25% before it pauses for “at least” two quarters, as relatively low borrowing costs will be required as the global economy grapples with widespread budget cutting and weakening consumer demand.

Meanwhile, most of the academics on the C.D. Howe council envisage the central bank’s rate hitting 2% and above by the end of 2010, and as high as 3.75% in one-year’s time. These academics argue that current rapid growth in money supply and higher-than-expected inflation will force the central bank’s hand.