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Record Low Rates to Remain

Les Whittington, Ottawa Bureau

OTTAWA - Canada is still not out of the woods yet on economic recovery, the Bank of Canada said as it announced that its trend-setting overnight rate will remain at a record-low 0.25 per cent.

The central bank said the global economy is beginning to pull out of its severe slump. But it said a return to normal economic growth hinges on financial pump-priming, low interest rates and bank bailouts.

"The global economic recovery is under way, supported by continued improvements in financial conditions and stronger domestic demand growth in many emerging-market economies," Bank Governor Mark Carney said.

But "while the outlook for global growth through 2010 and 2011 is somewhat stronger than the Bank had projected" in October, the recovery "continues to depend on exceptional monetary and fiscal stimulus," he said.

The less-than-robust recovery in Canada is also being hobbled by the strength of the Canadian dollar against the U.S. greenback on exchange markets. A higher dollar makes Canadian exports to the U.S. market less competitive. Compounding that is the continued weakness of the U.S. economy.

"The persistent strength of the Canadian dollar and the low absolute level of U.S. demand continue to act as significant drags on economic activity in Canada," the Bank said.

As a result, exports from Canada will play a less important role in the recovery than sales demand here at home, Carney observed.

The Bank said economic output in Canada was a negative 2.5 per cent in 2009. And Carney trimmed his growth prediction this year to 2.9 per cent, down marginally from the 3 per cent growth predicted for 2010 last fall.

As for 2011, he increased his prediction for expansion to 3.5 per cent, up from the Bank's earlier forecast of 3.3 per cent.

But there was nothing in Tuesday's statement to indicate the Bank would steer away from its commitment to maintain the current low interest rate setting until mid-2010. Carney said last year that, barring a burst of inflation, he would keep the rate at that level to spur economic activity.

The upsurge in economic activity that Carney would need to justify raising rates before the summer has not appeared, said RBC Economics chief economist Craig Wright.

"The growth numbers are still vulnerable," he said, adding that the performance of the economy in the July-through-September period was "much less than the Bank or anyone else was expecting."

He said the economy is operating well below capacity and unemployment is still high. "It will be a relatively weak growth recovery, and that suggests inflationary pressure will remain limited in the near term," Wright said.

But Carney can be expected to begin raising interest rates this coming summer, Wright said, with modest hikes in the second half of 2010 giving way to larger increases next year.

The Bank noted that the recession technically ended in the July-through-September period. According to Statistics Canada, the economy experienced meagre growth of 0.1 per cent in the third quarter. But that "is expected to have picked up further in the fourth quarter," the Bank said.

Nonetheless, Carney said, the economy was operating about 3.25 per cent below its optimum growth rate in the final months of 2009 and is not expected to return to optimum growth until the second half of 2011.

The next interest-rate setting will take place March 2.

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