

Canada Intraday Economic Commentary

BoC Governor Carney to Become BoE Head – Implications for Canada

- **What Happened** — Current Bank of Canada Governor Mark Carney was named the new Governor of the Bank of England, effective July 1, 2013. This is quite an historic event for both nations. The decision follows much earlier speculation that Governor Carney might be named for the position. Presently, no new Bank of Canada Governor has been chosen, and a formal recruitment process for the selection of the next BoC governor will take place shortly according to the central bank's website. It is possible that current Senior Deputy Governor Tiff Macklem will be a frontrunner for the Bank of Canada position.
- **Policy Implications** — For our purposes, we do not see any near-term implications for monetary policy. Since the state of affairs for Canadian growth, inflation, and household debt have not changed from yesterday to today, we maintain our expectation for a fixed policy rate target at 1% through July 2013, and anticipation that the bank will keep the slightly hawkish policy guidance, barring the realization of a confluence of downside risks – the US Fiscal Cliff being the most immediate. Since Governor Carney will be in office through July, we believe that he will continue to have a very strong influence on the Governing Council near term.
- **Succession Theories** — Again, current BoC Senior Deputy Governor Tiff Macklem likely is on the short-list for consideration for the next governor. It is difficult to know his precise views on monetary policy as, unlike for the United States Federal Reserve Board, dissent and meeting minutes are unpublished, and Governors rarely if ever deviate in public appearances from the Governing Council's consensus view printed in monetary policy statements or Monetary Policy Reports. As Mr. Macklem has worked very closely with Governor Carney throughout his tenure, it is likely that they share similar views on the role and direction of monetary policy ahead.
- **Announcement** — <http://www.bankofcanada.ca/2012/11/press-releases/bank-canada-governor-mark-carney-appointed-governor-bank-of-england/>

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Fixed Rates – For our purposes, we do not see any near-term implications for monetary policy heading into next week's meeting, or potentially for several months, as Mr. Carney is not set to begin his new job until the middle of next year. The economic outlook for Canada is unchanged in our view – GDP will be moderate given external headwinds, uncertainty and competitiveness (external and internal) pressures. Inflation will remain benign, with key indexes to return to the central bank's 2% target in the second half of 2013. The economy will continue to have a moderate degree of slack through the end of next year. Risks are unchanged today relative to a few weeks ago and they remain balanced in our view. All of these factors should cause the central bank to remain on the sidelines for some time.

Focus on Imbalances – Unless Canada experiences material strides in calming housing market activity and deceleration of credit market growth, we doubt that the bank will capitulate on its slightly hawkish rates guidance. Household debt as a percent of disposable income reached 167% in 2Q, housing investment as a share of GDP topped 7% in the second quarter and likely remained a significant share in the third, and officials have seen only nascent signs of moderation in the most distended housing markets (**Figures 1-3**). Moreover, October data reveal that mortgage credit is still growing at about 6.6% y/y – a rather rapid pace (**Figure 4**).

Retention of Bias – Moreover, relenting on the combative tone towards imbalances associated with household debt by the BoC would be counterproductive, in our view, to efforts underway by the Finance Ministry and OSFI to address a key risk to the inflation outlook and the financial system as a whole. The central bank dug its heels in further on this front in October, stating that household imbalances would play a more prominent role in the policy calculus ahead. We doubt that over the next nine months or so that the Governing Council, Governor Carney or his successor would desire to disrupt efforts to address the most serious domestically focused risk to the economy.

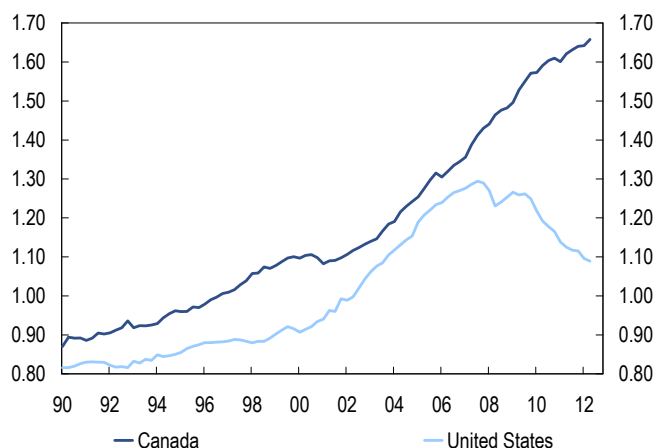
The Policy Path – Since the state of affairs for Canadian growth, inflation, and household debt have not changed from yesterday to today, we maintain our expectation for a fixed policy rate target at 1% through July 2013, and anticipation that the bank will keep the slightly hawkish policy guidance, barring the realization of a confluence of downside risks – the US Fiscal Cliff being the most immediate. Since Governor Carney will be in office through July, we believe that he will continue to have a very strong influence on the Governing Council near term.

The Successor's Influence – Again, current BoC Senior Deputy Governor Tiff Macklem likely is on the short-list for consideration for the next governor. It is difficult to know his precise views on monetary policy as, unlike for the United States Federal Reserve Board, dissention and meeting minutes are unpublished, and Governors rarely if ever deviate in public appearances from the Governing Council's consensus view printed in monetary policy statements or Monetary Policy Reports. As Mr. Macklem has worked very closely with Governor Carney throughout his tenure, it is likely that they share similar views on the role and direction of monetary policy ahead.

Final Thoughts – As key uncertainties are resolved, global growth stabilizes and Canadian domestic risks recede over the medium term, the nation will become ripe for some removal of the extraordinary degree of monetary policy accommodation currently in place. Absent any concrete information on whom the next BoC Governor might be or the views of potential candidates, particularly the most likely successor, we continue to posit that scope for tightening will be in order for the second half of next year. We expect about 50 basis points to 1.50% by December 2013. We also continue to contend that the degree and pace of monetary policy normalization will be modest and protracted thereafter, with an additional 150 basis points of tightening over the 2014 to 2016 span to 3.00%.

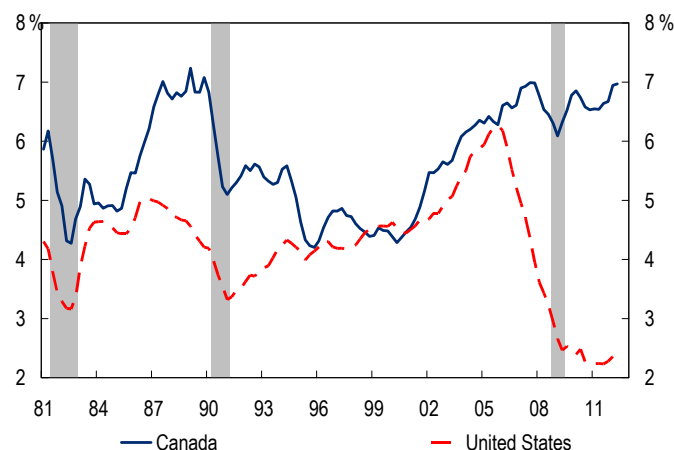
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Figure 1. Global–Household Debt-Disposable Income Ratio, 1990–2Q 12



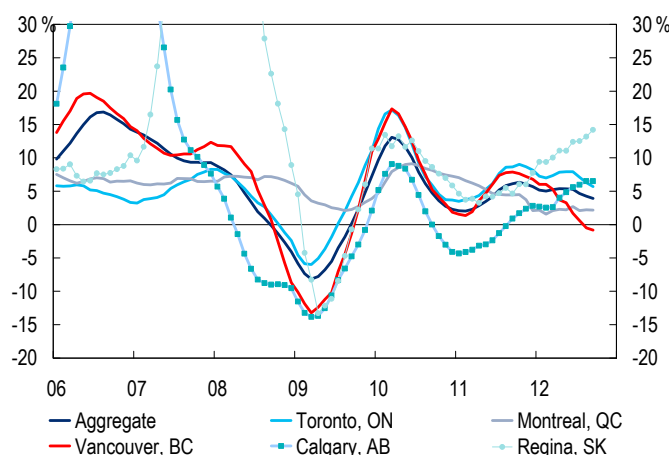
Sources: Statistics Canada and Federal Reserve Board.

Figure 2. Global – Housing Investment as a Share of GDP, 1961 – 3Q 12



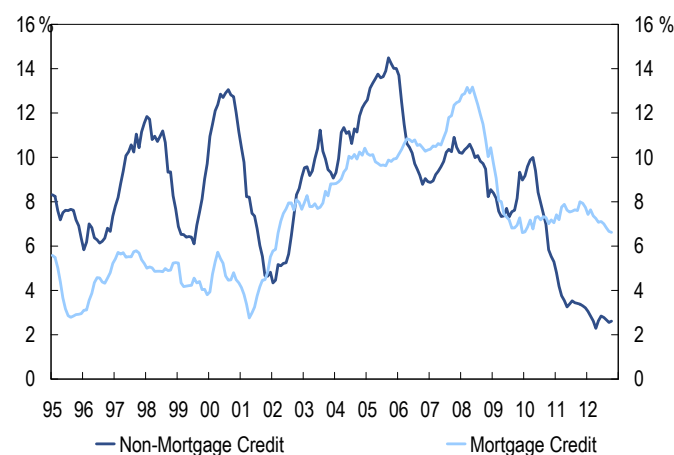
Note: Shaded areas denote Canadian recessions. Sources: Statistics Canada & BEA.

Figure 3. Canada–Resale MLS Home Price Indexes (Y/Y%), 2006–Oct 12



Source: CREA/MLS.

Figure 4. Canada – Consumer Credit (Y/Y%), 1995 – Oct 12



Source: Bank of Canada.

Appendix A-1

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