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Canada Rebound Lets Carney Signal Rate Divergence From U.S.
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By Greg Quinn

April 21 (Bloomberg) -- Canada will raise interest rates before the U.S. Federal Reserve for the first time since 2002, as the country's economy rebounds from a global recession faster than other Group of Seven countries.

The Bank of Canada said yesterday the time for keeping its policy rate at a record low 0.25 percent "is passing." The Canadian dollar rose by as much as 1.6 percent as investors bet Governor Mark Carney will raise lending rates at the next announcement on June 1, opening a gap with the U.S. Federal Reserve.

Canada's economy has been supported by a banking system rated the world's soundest by the World Economic Forum for two straight years, housing prices that have returned to near-record levels, and rising demand and prices for many of the commodities the country exports such as oil and copper. Carney raised his growth forecast for 2010 to 3.7 percent from 2.9 percent and said the economy will expand 3.1 percent in 2011.

"Canada can be looked at as being ahead of the pack in terms of the recovery," said Jimmy Jean, who covers Canada for Moody's Economy.com in West Chester, Pennsylvania. "That's why Canada has to be ahead of the pack in terms of policy rate normalization."

A widening interest-rate gap may lead to further appreciation in the Canadian dollar, testing the view held by Finance Minister Jim Flaherty that exporters have become more competitive and can handle a stronger currency. The country's dollar may trade at 95 Canadian cents per U.S. dollar at year- end, said David Semmens, an economist with Standard Chartered Bank in New York.

Front-Loaded Growth

"The only concern that we have is that they're so closely interlinked to the U.S.," Semmens said. "That's really got to be the big question mark for the outlook for Canada at the moment."

Economic growth is more "front-loaded," the Bank of Canada said yesterday, cutting its forecast for next year to 3.1 percent from 3.5 percent, and making its first projection for 2012 growth of 1.9 percent. Growth is being fed by a recovering global economy, "very strong housing activity" and government stimulus, the bank said in its statement.

Even automobile and lumber companies -- among the hardest hit last year by the recession -- are seeing a rebound. General Motors Co. said March 26 it plans to add a third shift at its Oshawa, Ontario, plant.

Canada Next

The Bank of England led by Governor Mervyn King has kept the base rate at a record low 0.5 percent since March 2009. The Frankfurt-based ECB on April 8 kept its benchmark interest rate at a record low of 1 percent and President Jean-Claude Trichet forecast inflation will remain "moderate" through 2010. The Bank of Japan has kept its benchmark rate at 0.1 percent since December 2008.

"Emerging markets have recovered followed by the commodity economies," such as Australia and Norway, said Amelia Bourdeau, a currency strategist in Stamford, Connecticut, at UBS AG. "Logic follows it's Canada next."

The Federal Reserve may not raise its rate until the third quarter according to economists surveyed by Bloomberg News, and by the first quarter of next year Canada's rate may be 1.75 percent compared with 1 percent for the Fed.

"We enjoyed a relatively mild recession compared to other countries and our fundamentals were quite strong," said John Manley, head of the Canadian Council of Chief Executives and a former Canada finance minister. "There's been a lot of interest in Canadian-dollar-denominated assets, including government bonds, which reflects that we've got a pretty good reputation right now."

'Limits'

The Canadian dollar rose the most since November yesterday after the bank's statement. The currency, which has gained 24 percent over the past year, was worth more than its U.S. counterpart on April 6 for the first time since July 2008.

"There are inherent limits to how far the Bank of Canada can raise rates beyond those in the U.S., but I don't see a problem with Bank of Canada raising rates 1.25-1.5 points beyond what the Fed does," said Craig Alexander, deputy chief economist at TD Bank Financial Group in Toronto.

"A strong dollar is going to be a challenge for exports, but the domestic economy can still support moderate growth," Alexander said.

Canada's economy will grow at the fastest pace in the G-7 this year, according to economists surveyed by Bloomberg News. Finance Minister Jim Flaherty has said companies are better able to handle a stronger Canadian dollar and changes in global demand, and said the economy has benefited from a financial system where no banks failed or sought a bailout.

"The world has just been through the most serious credit crisis in at least a generation," Flaherty said yesterday in the federal legislature. "Fortunately, in this country we have a very sound banking system."

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