



## Retail sales dip in November

Retail sales in British Columbia dipped in November 2004, according to Statistics Canada's latest estimate. Seasonally adjusted sales totalled \$3.96 billion, down 1.2% from October. It is not unusual for retail sales to have the odd soft month, especially since most of 2004 has seen above-average sales growth. November's sales were up almost 7% from one year earlier and year-to-date sales rose 6.4% from the same period a year earlier.

Sales were down in November owing to lower volumes on new and used cars, recreational vehicles, auto parts and general merchandise. These declines were partly offset by increased sales of building supplies, food, pharmaceuticals and miscellaneous goods.

Further growth in retail sales is foreseen in 2005, though at a lesser pace than last year. Credit Union Central of B.C. forecasts retail sales in B.C. will increase by about 5.5% in 2005 and 6% in 2006, following growth of 6.5% in 2004.

### Bank of Canada on hold, sees improving economy

The Bank of Canada held its key lending rate steady at 2.50%, citing weaker-than-expected growth in the fourth quarter, mainly due to a higher Canadian dollar. In its latest Monetary Policy Report Update, the Bank lowered slightly its 2004 and 2005 economic growth forecasts, but it raised its 2006 growth expectation. With growth in 2004 and 2005 expected to be below the economy's long-run potential rate of 3%, the output gap will widen this year and there will be less inflation pressure. And to be consistent, the Bank lowered its inflation forecast for this year as well.

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Retail Sales, Seasonally Adjusted, B.C.



Source: Statistics Canada.

The Bank's analysis suggests no movement in rates for a while, but a reduction in monetary stimulus will be needed. And, definitely, no rate cut is foreseen. The telling feature is the Bank's 2006 forecast calling for growth to rise to 3.3% from 2.8% this year and for inflation to almost reach the 2% target by the end of 2006.

Growth over 3% means that the output gap will close and the inflation rate will rise, setting the stage for higher interest rates. The Bank's 2006 forecast reflects its cautious approach to monetary policy and its preference to err on the side of caution. It would prefer to keep monetary policy tighter and cut later, rather than have a looser stance and risk inflation flaring up, creating a tougher battle for the Bank to fight. And, were the Bank to forecast 3% or less growth in 2006, it would signal lower rates. The 2006 forecast is more important than this year's, since monetary policy operates with a time lag and the Bank needs to look ahead one to two years to set rates today.

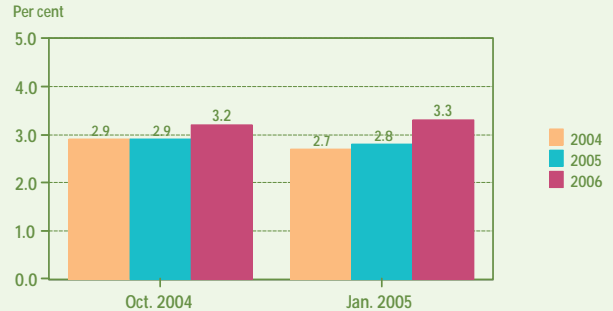
Other forecasters see 2006 growth in the 2.4% to 3.5% range, with a mean forecast of 3%. The mean forecast for 2005 is 2.9%, with a range of 2.5% to 3.4%. Clearly there is considerable disagreement about the economy's growth performance and the Bank mentioned that uncertainty in its report, particularly concerning the trade sector.

The Bank does not reveal the interest rate and exchange rate forecast assumptions behind its forecast, but it did state that it slightly lowered the crude oil price forecast and raised the U.S. economic forecast. It sees a slightly stronger domestic sector than before and a weaker trade sector (net exports) in 2005 and 2006. The Bank is the first to revise its 2006 forecast upward, and other forecasters may follow suit, though that remains to be seen.

Incoming data during the next few months will likely reveal somewhat weaker overall growth than expected by the Bank. Our forecast calls for growth of 2.8% in 2005 and 2.7% in 2006. The 2006 forecast sets up our expectation of a rate cut later this year and another in 2006. A lower inflation rate is expected due to the persistence of a negative output gap and to the higher Canadian dollar.

## Bank of Canada lowers 2005 growth forecast, raises 2006

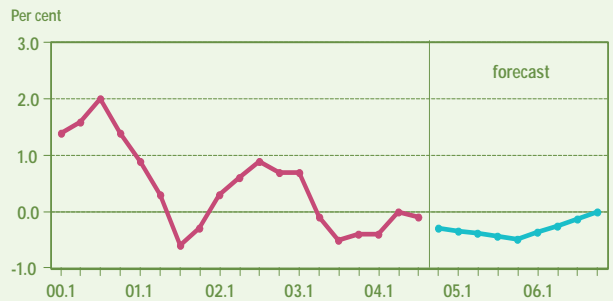
### Bank of Canada's Real GDP Forecasts



Source: Bank of Canada, Monetary Policy Report.

## Output gap closes on cue

### Canada's Output Gap, Estimated and Forecast, Quarterly



Source: Bank of Canada. Latest actual: Q3 2004. Forecast based on 3% potential growth and Bank of Canada GDP forecast.