Bank of Canada Preview: January 2021

Details:

Monetary Policy Announcement:
1000ET: Interest rate announcement for the overnight rate target together with a short explanation of the factors influencing the decision. The full update of the Bank's outlook for the economy and inflation, including risks to the projection, will be published in the MPR at the same time.

1100ET: Press conference by Governor Tiff Macklem to discuss the MPR. Link: https://www.bankofcanada.ca/multimedia/mpr-press-conference-webcasts-january-2021/

Point of View (POV) Steady at 0.25%

Consensus: The Bank of Canada will keep its target rate on hold at 0.25% Wednesday, while holding asset purchases steady at CAD4B/week. Covid-19 and it's more infectious variants continue to weigh on economic activity necessitating the Bank to remain highly accommodative. That said, positive vaccine developments are lending hope to quicker economic recovery. Dovish/hawkish risks to consensus outlook:

Dovish risk: While Governor Tiff Macklem continues to categorically rule out the chance of negative rates, a minority of sell-side analysts suggest there is a chance the BOC implement a micro-cut as a way to provide additional stimulus if needed, say in the event tighter lock-down restrictions weigh on the economic outlook. More quantitative easing and/or yield curve control remain additional options if needed.

Hawkish risk: Tighter policy implementation is still way off. While the economic outlook is improved on balance, hiking rates after reaching and sustaining 2% inflation remains a long way off (late 2022- to 2023 est).

Central Bank Watch - Bank of Canada

January 20, 2021

MNI Bank of Canada Data Watch List

Inflation		Current	3m ago	3m Chg	6m ago	6m Chg	2Y History	Hit / Miss	Vs Trend	Surprise Index	Z-Score
CPI	% y/y	1.0	0.1	↑	-0.4	↑					-0.44
Core CPI - Median	% y/y	1.9	1.8	↑	1.8	↑					0.35
Industrial Product Price	% m/m	-0.6	1.0	↓	0.9	↓					-0.69
Breakeven 10-Year	%	1.51	1.18	↑	0.84	↑					1.10
Economic Activity		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
PMI Manufacturing	Index	57.9	56.0	↑	47.8	↑					1.44
GDP	% m/m	0.4	2.5	↓	-11.4	↑					0.13
Manufacturing Sales	% m/m	-0.60	-1.68	↑	11.63	↓					-0.16
Trade Balance	CAD bn	-3.34	-3.09	↓	-1.72	↓					-0.19
Monetary Analysis		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
M3 Money Supply	% y/y	12.23	15.97	↓	13.07	↓					0.70
Bank Lending Survey (Q)	% m/m	7.28	19.16	↓	7.69	↓					0.64
New House Prices	% m/m	0.6	0.5	↑	0.1	↑					0.34
Housing Starts	K	228.3	209.0	↑	212.0	↑					-0.08
Consumer / Labour Market		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
Retail Sales	% m/m	0.4	1.3	↓	-24.8	↑					-0.08
Retail sales Ex-Autos	% m/m	0.0	0.2	↓	-20.7	↑					-0.10
Employment Chge m/m	K	-62.6	378.2	↓	952.9	↓					-1.15
Ave Hourly Wage Rate	% y/y	5.43	5.43	→	6.80	↓					-0.45
Markets		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
S&P/TSX Composite	Index	17957	16121	↑	15515	↑					1.41
Canadian 10-Year Yield	%	0.80	0.56	↑	0.53	↑					1.10
CAD Yield Curve (2s-10s)	bps	65.2	31.4	↑	23.6	↑					1.48
CAD TWI	Index	122.58	117.58	↑	116.12	↑					1.68

Note: For quarterly data the 3m ago column will display the previous data point and the 6m ago column will display the data point prior to that.
Source: MNI, Bloomberg

Business Address – MNI Market News, 5th Floor, 69 Leadenhall Street, London, EC3M 2DB

Analyst Views

Bank of America: We expect a status-quo decision by the Bank of Canada: rates at 0.25%, same forward guidance and purchases of C$4bn per week. The BoC is currently providing ample monetary stimulus and will continue to do so for many months as the economy remains weak.

- GDP growth will accelerate as soon as 2Q but the vaccination process will continue and eventually will win the race. Canada has an ample and diversified portfolio of vaccines available and despite the logistic problems it will likely achieve the goal of inoculating most of its population by the fall. Once the most vulnerable population is vaccinated mobility will increase and demand for services will also increase, supporting growth. We expect Canadian GDP growth at 5% in 2021 and believe the Monetary Policy Report will show a GDP growth forecast revision toward our number (up from the 3.1% published in the October MPR), despite the slow start to the year.

Bank of New York Mellon: The BOC "is unlikely to adjust interest rates or change it's quantitative easing policy amid near-term risks to the outlook associated with the COVID crisis. Consensus is for no rate cut, but there has been chatter that the BoC could telegraph a potential future "micro cut" to its overnight rate (currently at 0.25%). While it would be a slight surprise, it could sap some of the recent strength of the Canadian dollar, sending USD/CAD higher.

- The BoC's quarterly monetary policy report will be released on the same day and will include revised staff forecasts for economic growth. We will be interested to see if the bourgeoning pandemic and lockdowns across the country will lead to any downgrades - we think it will.
- Currently the consensus expectation for Canadian GDP growth sees 2.8% in Q4 2020, 2.1% in Q1 2021, and 4/4% for the whole of this year. The BoC's current forecast, published in October's Monetary Policy Report, is for -4.3% in the last quarter of last year, and 3.8% for 2021. We'll see new quarterly forecasts for 2021 and think that BoC's near-term forecasts will be much lower than the street's consensus.

Bank of Montreal: Steady at 0.25.

CIBC Capital Markets: Steady at 0.25. there will be no changes to administered rates, no technical adjustments and no alteration to the current QE structure. Admittedly, what makes us nervous is the fact that central bankers don't just say things for 'fun'. Discussion around a lower effective-lower-bound (ELB), at the very least, means the Governing Council (GC) is thinking about how to add more stimulus.

- CIBC sees "yields declining from current levels" while the "relative move should lead to CAD rates underperformance. From a cross-market perspective, CAD rates have richened across the curve versus the U.S. But the move in 2s and 5s is more a reflection of potential BoC action next week (read: micro-cut), whereas the move in 10s and 30s (which have smaller outright moves) is more a function of relative adjustments in the level of real yields and breakevens. That leaves us inclined to fade the recent outperformance of longer-duration Canadian yields, with 10yrs our preferred way to express this view. And while domestic rates have outperformed, the relative shape of the curve has actually out-steepened the U.S. This curve underperformance has led to, for example, the CA/US 5s30s box cheapening some 10.0bps since the Senate election results, while the 10s30s box has shown a similar sized move. The former is now at levels last seen in July, while the latter is at the highest level since early-May."

Citigroup: Steady at 0.25. Citi Economics expect The Bank of Canada should keep rates and asset purchases unchanged while upgrading growth forecasts in the January MPR. The team also projects headline CPI should continue its rise back towards 2%, increasing to 1.1%YoY in December

Credit Agricole: Our economist expects the BoC policy meeting to be largely uneventful while the CPI data could confirm that the recent gradual recovery remains in place. Indeed, we think that the BoC will maintain a stable outlook given that policy rates are at their lower bound and after the policy measures the MPC announced late last year to lengthen the average maturity of its QE purchases.

Business Address – MNI Market News, 5th Floor, 69 Leadenhall Street, London, EC3M 2DB

Goldman Sachs: Steady at 0.25. We again expect the BoC on Wednesday to strike a balanced but cautiously optimistic tone on the outlook beyond Q1 and leave its policy rate and forward guidance unchanged. Specifically, our key expectations are:

- Negative Q1 growth: We expect the MPR to show slightly negative growth in Q1 following new restrictions and concerns from Governor Makclem that rising covid-19 infections could "deepen our economic hole".
- Upgrades to 2021 and 2022 growth: We expect significant upgrades to the 2021 and 2022 growth projections, previously at 3.8% and 3.0% on a Q4/Q4 basis. That is because we expect the Bank to pull forward its mid-2022 timeline for wide vaccine availability, and to incorporate fiscal stimulus in Canada and the US, and higher oil prices.
- Upgrades to 2021 and 2022 inflation: We also expect the end-2021 and end-2022 CPI projections of 1.3% and 1.8% to be upgraded reflecting stronger growth and less slack.
- Balance upgrades with concerns: While the BoC's medium-run baseline outlook should look brighter, we expect policymakers to aim to balance the message by expressing concerns over the near-term outlook, highlight significant virus uncertainty, and reiterate risks to exports from currency appreciation.
- No micro cut: An update on the BoC's assessment whether the effective lower bound could be below 0.25% might increase market pricing of a micro rate cut somewhat, even if we don't think such a cut will happen.
- Forward guidance unchanged: We expect policymakers to stick to the guidance that QE will continue until the recovery is well underway and to hold the policy rate at the lower bound until inflation sustainably reaches 2% and slack is fully absorbed.

ING: Steady at 0.25. Core CPI may linger around 1.00%, but this should not have any clear implications for the BoC policy decision. In fact, we don't expect the BoC to announce any new measures on Wednesday. The vaccine-related hopes have fuel led the prospects of a quicker economic recovery, but the contagion picture in Canada has worsened of late and in general there would be no reasons at this stage for Governor Tiff Macklem to sound any hawkish. The BoC may simply reiterate its lower-for-longer pledge. Accordingly, we expect CAD to be only marginally touched by the policy meeting and more dependent on external factors in the week ahead.

JP Morgan: Steady at 0.25 while JPM expects the Bank of Canada "will continue to lean dovish."
With the second wave of the COVID-19 virus still apparent and the strictest lockdown measures since the spring of 2020 weighing on economic activity, we maintain that the Bank will continue to confirm the need for highly accommodative monetary policy. We expect the Bank to keep the policy rate at the ELB (0.25%) and maintain the output-based forward guidance through 2021.

- As to the MPR, "The Bank's 4Q20 real GDP forecast will have to be revised up as data in hand suggest a growth rate above the Banks's 1.0%, forecast from the October MPR. Activity data reported so far for the fourth quarter has been surprisingly decent considering the steep uptrend in new cases and the building provincial containment measures. Since the beginning of 2021, however, provincial authorities have severely clamped down on service activity and general mobility with the strictest containment measures since spring of 2020. A recently announced province-wide stay-at-home order in Ontario and an extension of emergency containment measures in the province for an additional 30 days to February 19 suggests downside risk to our 1Q real GDP forecast of -1.0%.
- The main downside risk now lies more with the duration of restrictions rather than the severity. Despite the weak start to the year, we believe the Bank may turn somewhat more bullish on 2021 growth overall on a stronger re-opening rebound and a ramp up in vaccine distribution. The Bank may also adopt a generally more optimistic view on global growth given stronger growth is expected in the US. Nevertheless, similar to the last forecast update in October, the Bank will label the outlook unusually uncertain. Given expectations for stronger growth, we think that the Bank's QE program is the aspect of policy most likely to change in the near-term. The Bank may start tapering toward year-end although we believe any moves to the exit ramp would be gradual and telegraphed well in advance."

Morgan Stanley: Steady at 0.25.

Business Address – MNI Market News, 5th Floor, 69 Leadenhall Street, London, EC3M 2DB

NatWest: Steady at 0.25, No major changes. Like the US and UK, Canada is currently experiencing a spike in Covid-19 cases (Global Covid Monitor), and upcoming economic data may weaken to reflect that surge. December employment in Canada slipped for the first time since April. This increases the risk of a more dovish tone through the statement, though we think long term forecasts will continue to reflect optimism over the coming years as vaccination rates pick up and the economy recovers further. The BoC opted not to engage in FX jawboning in its December statement, though we'll be on the lookout for any FX jawboning in January's communications.

- There is an option for additional easing on the table at this meeting. Indeed, Deputy Governor Beaudry suggested an RBA-style "mini-cut" in his speech following the December meeting. He noted that if the economy takes a more "persistent turn for the worse", one option available to the BoC could be to "reassess the effective lower bound, which would allow for the possibility of a lower—but still positive—policy rate."
- We don't anticipate the BoC taking a move of this sort in January, given the poor data of late is unlikely to be judged to be persistent (to use Beaudry's term). But discussion of a possible mini cut could be a feature of the post-decision press conference. Note that BoC research has previously suggested that the effective lower bound may be below zero, even though the central bank has consistently, and repeatedly, rejected a negative policy rate.

Rabobank: 25bp will remain the effective lower bound where rates are anchored through 2023. However, "There has been talk recently of a potential "mini cut" from the BoC taking the policy rate down through 25bp to 20bp or 15bp. The front-end of the CAD OIS curve is suggesting this is a real possibility.

- Although 0.25% has been described as the effective lower bound in Canada, there is the possibility that there could be an effective 'even lower' bound with the potential for Canada to break from the norm of moving policy rates in 25bp multiple clips with a mini cut. CAD OIS points to a 5bp cut and Governor Macklem has left the door open for further easing even if that is not the base case.
- All this said, we suspect that we won't see another cut from the BoC even if it is just a 5bp clip.

RBC: Steady at 0.25. We expect no change in the overnight rate, forward guidance, or QE purchases at Wednesday's meeting. The BoC's projection is very likely to be upgraded, as the previous one from the October 28th MPR was before positive vaccine developments. Near-term forecasts should be mixed, with Q4 upgraded from +1.0% annualized (RBC at +4.5%), while Q1 could be negative (our latest forecast is flat).

- There is some focus in the lead-up on a possible move lower in the effective lower bound to a still positive number (e.g., from 25bp to 10bp) after BoC communication late last year. While this is an option if the BoC sees more stimulus as necessary, we do not think that will be its assessment given the improved medium-term outlook and strong fiscal backstop to manage near-term virus risks.
- Despite the improved projection, we do not expect the BoC to move the forward guidance timeline (based on slack removal, inflation sustainably at target) from 2023 to late 2022. However, we do expect this to come later in 2021 and see an eventual first hike from the BoC in Q3-2022.

Scotiabank: Steady at 0.25, The BoC meeting is not expected to lead to any changes in policy. There has been some talk of a so-called "micro" cut in rates … of perhaps 10bps. While this option might be in the BoC toolbox, using it would be of questionable value as it will not impact the near-term trajectory of the economy.

- The street is looking for no change in rates and that perspective is reflected in OIS contracts which reflect expectations for no change in policy from the BoC or the Fed in the next 12 months. The MPR and press conference may be of more interest – for the Bank's perspective on the outlook and any additional comments on the CAD.

TD Securities: Steady at 0.25, with no change in either the QE program or forward guidance. The January meeting will be accompanied by an updated monetary policy report and new forecasts. Even with incrementally tighter public health measures coming into effect seemingly every week, we still expect to see positive forecast revisions across the BoC's forecast horizon.

- Over the last few months, the Bank of Canada has opened the door to potentially cutting rates; Macklem continues to categorically rule out negative rates, but there is a clear implication that the BoC has examined a 10-15 bp cut. BoC discussions of possible rate cuts have been presented in the context of providing more stimulus, with Governor Macklem arguing that if more stimulus were required the Bank could do one of three things: more QE, Yield Curve Control, and cutting rates while keeping them positive. With the economic outlook improving on balance, we don't think more stimulus is required here.

MNI Policy

MNI STATE OF PLAY: BOC Seen Holding CAD4B/Wk QE and 0.25% Rate

By Greg Quinn

OTTAWA (MNI) - The Bank of Canada on Wednesday will likely press on with at least CAD4 billion a week of asset purchases and a 0.25% interest rate, as a second wave of the pandemic stalls the economy and pushes back the rebound expected later this year when vaccines are widely available.

All 14 economists surveyed by MNI predict no change in the record low rate, and eight of nine see QE steady as well. The country has gone back to stricter lockdowns after holiday gatherings triggered record Covid-19 caseloads, backing Governor Tiff Macklem's hesitancy to embrace near-term optimism about vaccine breakthroughs.

With no growth or a contraction expected this quarter, there will likely be no clear BOC message about progress towards its goal of ensuring the economic rebound is well underway before ending with QE.

Inflation remains at 1%, the bottom end of the BOC's tolerance band in its single-target regime of keeping prices running at 2%. The stronger Canadian dollar that Macklem has drawn attention to at the last two decisions has also appreciated another cent to CAD1.28 against the greenback since the start of December.

RESILIENCE MEANS APRIL TAPER

Sources have told MNI that while the BOC may now assume most people get vaccinated sooner than its October estimate of mid-2022, policy makers may also wait before fully upgrading growth forecasts.

The BOC's October Monetary Policy Report predicted 4.2% growth in 2021following a 5.7% drop this year, and some market economists see the BOC moving its 2021 forecast more toward 5%.

On the plus side, the economy was stronger than expected in the fourth quarter, though with GDP still 4% below the pre-pandemic mark. While about a million workers are still out or work or on reduced hours because of the pandemic, that's also well below the peak of 5.5 million.

Finally, with the government promising most of the nation will receive vaccines by around September, households could spend the more than CAD50 billion of cash they saved from relief payouts.

Given such markers of progress, economists surveyed by MNI say the BOC will taper to CAD3 billion in April. Some investors also see the BOC needing to avoid frictions created with the central bank on track to own half the government bond market this year.

KEEPING STIMULUS IN PLACE

"While highlighting an economic acceleration after mass vaccination starts in the spring," CIBC chief economist Avery Shenfeld wrote in a research note, "the overriding message will be that stimulus will be warranted for a considerable period ahead."

Macklem has said he doesn't see the conditions for a rate increase -- inflation solidly back at 2% and economic slack used up -- until into 2023. A small minority of market watchers say not to rule out the chance Macklem will follow through on remarks last month that it could beneficial to cut the policy rate while still leaving it above zero. Still, with business investment lagging for years even with record low rates, the pandemic dominating the outlook, and the government providing the biggest fiscal boost among major economies, it's unclear what good another rate cut would do.

MNI POLICY: BOC May Taper QE in April, Exit Mid-22- Survey

By Anahita Alinejad and Greg Quinn

OTTAWA (MNI) - The Bank of Canada will scale back QE again as soon as April and wind up the program by mid-2022, an MNI survey found, potentially well ahead of other major central banks in finding the exit.

All five economists who responded to an email survey over the last week said asset purchases will end sometime in 2022, with three of those saying the exit will come early or in the first half of the year.

The BOC began buying at least CAD5 billion of assets a week last year, later tapering it to CAD4 billion while shifting to longer-term securities and saying that provided just as much stimulus. Governor Tiff Macklem says the program will continue until the economic rebound is well underway, and he doesn't expect conditions for a rate increase until into 2023.

Investors seeing QE scaled back cite vaccines due to be widely available by this fall in Canada, and a pace of purchases that could impair markets with the BOC on a path to own half of the government's bonds. While downplaying the market friction argument, Macklem has said it's logical to move on QE before raising the 0.25% policy interest rate.

TAKING A BILLION OFF

The MNI survey has three of five respondents saying the next QE tapering could be as soon as the April meeting. The other two said it would be as soon as July. The next policy decision is on Wednesday.

Whenever the next tapering comes, it will slow the pace to CAD3 billion, according to four of five of the responses. The other economist saw a reduction to CAD2 billion. The survey didn't show a strong view of whether the BOC would again adjust the duration of the assets being purchased.

Shutting down QE by 2022 would likely make Canada an outlier given the Fed, ECB and BOJ have taken much longer to fully scale back, or have never really done so, since the global financial crisis. Canada avoided using pure QE after 2008, and the financial system has been resilient to banking or housing collapses. In this downturn, the government has also provided the biggest fiscal stimulus among major economies, taking pressure off of monetary policy.

The BOC's balance sheet has swelled to around a record CAD550 billion since last spring when the Covid-19 pandemic hit, including around CAD300 billion of federal bonds and CAD150 billion of repos.
Even if QE is halted, it could still take much longer for the balance sheet to return to the CAD125 billion seen before the pandemic. The BOC has said it could re-invest some proceeds of maturing assets while outright sales of its balance sheet holdings would be on the more aggressive end of its potential moves.