Bank of Canada Preview: July 2021

The Bank of Canada is widely expected to keep its target rate on hold at 0.25% -- the eleventh consecutive policy announcement Wednesday at 1000ET. Sell-side analysts also anticipate a CAD1B decline in weekly bond purchases to CAD2B/week amid strong economic optimism tied to fiscal support and vaccination efforts that blunted the pandemic's drag on the economy.

Monetary Policy Announcement:
The interest rate announcement at 1000ET is accompanied by an updated quarterly economic forecast. There is no media briefing or lock-up scheduled for the event. The Bank will also publish its quarterly Monetary Policy Report (MPR) at the same time as the rate decision. Link: BOC

Monetary Policy Report webcast at 1100ET. Tiff Macklem, Governor of the Bank of Canada, will hold a teleconference to discuss the Bank's base-case projection for inflation and growth in the Canadian economy, and its assessment of risks. Link: MPR

The next rate announcement on Wednesday, September 8, 2021, will not include the quarterly Monetary Policy Report (MPR).

Point of View (POV)

Consensus: The Bank of Canada will keep its target rate on hold at 0.25% Wednesday, while reducing weekly bond purchases CAD1B to CAD2B/week is widely expected. Forward guidance: unwilling to spook markets, the Bank is widely expected to remain at the current lower bound of 0.25 until mid- to second half of 2022.

Dovish risk: Economic improvement and inflationary factors to this point deemed transitory, perhaps staying the BoC's hand in tapering weekly bond purchases. Continued fiscal support, swift vaccination and careful approach to reopening has helped economic rebound, but there's still enough slack in the economy to warrant a gradual approach to normalization.

Hawkish risk: On the flipside, if the economic rebound is deemed stronger than expected, there is a chance the BOC taps the breaks a little harder, perhaps by moving forward timing of the output gap closing or tapering more than the anticipated C$1B.

- Scotiabank posited "reducing purchases down to, say, $1 billion in one swoop at this meeting would likely set up expectations for an end to the purchase program, perhaps at the September meeting, with pulled-forward expectations for a reinvestment phase and rate hikes. That's not inconceivable, but would signal a greater rush to exit than Governor Macklem's guidance has tended to indicate to date."

mni

All Signal, No Noise

MARKET ANALYSIS

mni Central Bank Watch - Bank of Canada

July 13, 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	3.6	1.1	↑	1.0	↑					2.05
Core CPI - Median	% y/y	2.4	2.0	↑	2.1	↑					1.85
Industrial Product Price	% m/m	2.7	2.8	↓	-0.4	↑					1.00
Breakeven 10-Year	%	1.68	1.77	↓	1.38	↑					0.53
Economic Activity		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
PMI Manufacturing	Index	56.5	58.5	↓	57.9	↓					0.80
GDP	% m/m	-0.3	0.7	↓	0.7	↓					-1.76
Manufacturing Sales	% m/m	-2.09	3.55	↓	0.34	↓					-1.46
Trade Balance	CAD bn	-1.39	1.09	↓	-3.28	↑					-0.11
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	4.83	11.94	↓	12.24	↓					-1.82
Bank Lending Survey (Q)	% m/m	-14.95	-3.03	↓	7.28	↓					-1.22
New House Prices	% m/m	1.4	1.9	↓	0.6	↑					0.52
Housing Starts	K	275.9	270.8	↑	262.0	↑					0.12
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	-5.7	0.2	↓	1.2	↓					-1.50
Retail sales Ex-Autos	% m/m	-7.2	0.2	↓	1.4	↓					-1.70
Employment Chge m/m	K	230.7	303.1	↓	-52.7	↑					0.93
Ave Hourly Wage Rate	% y/y	0.10	2.01	↓	5.37	↓					-0.75
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	20233	18701	↑	17433	↑					2.14
Canadian 10-Year Yield	%	1.31	1.56	↓	0.68	↑					0.50
CAD Yield Curve (2s-10s)	bps	83.0	133.2	↓	47.6	↑					0.05
CAD TWI	Index	125.34	124.74	↑	122.19	↑					0.66

Analyst Views

Summary of select analyst views: Unanimous agreement of steady rate and tapering weekly bond purchases from C$3B to C$2B.

Bank of America: We expect the Bank of Canada (BoC) to remain on hold on 14 July, but reduce its bond purchases to at least C$2bn per week from the current C$3bn. We expect the BoC to taper again at this meeting because the economy is clearly recovering and the third COVID wave seems to be mostly contained, allowing for a gradual reopening. But we think it is unlikely the BoC will change its forward guidance at this time.

- Granted, the BoC will likely increase its GDP growth and inflation forecasts in July's Monetary Policy Report (MPR), but not enough to bring the first rate hike forward, in our view. The central bank will probably continue to say it expects economic slack to be absorbed sometime in 2H 2022. We expect the output gap to close before that, so there is a risk the BoC turns out more hawkish, but the labor market will likely still have some slack this year and most of next, which we think would prevent the BoC to move earlier. We still expect the BoC to keep its policy rate at the effective lower bound until 2H 2022.

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Bank of Montreal: This is an MPR meeting, so we'll get fresh forecasts and a press conference. Since the April MPR, things have evolved largely as the BoC expected. They missed modestly on Q1 GDP, which was shrugged off in the June statement, and Q2 appears to have been dampened only modestly by the third wave. Meantime, the C$ has backed off, the Fed is now talking about tapering, and the reopenings appear poised to continue through the summer.

- Vaccinations are on pace for Canada to have broad immunity by the fall. All told, there's nothing here to change their projection for the output gap to close in 2022H2. Given the GDP miss in Q1 (and probably small in Q2), it shouldn't be pulled forward, but those misses aren't enough to push it back either. Also, the improvement in the labour market is consistent with all of the above.
- The reopening is driving a rebound in services jobs which is expected to continue through the summer. We'll see how much momentum there is in the fall, but that's a worry for another day. We're not expecting any changes to the WAM of QE. If the BoC didn't make any changes in April, there's no reason to soften the taper this time around. If anything, there's notably less uncertainty now, leaving little rationale to change tack.

Barclays: Steady at 0.25 and tapering GoC bond purchases from C$3B to C$2B, citing "strong economic recovery, which was not materially derailed by the third COVID wave. BoC speakers have highlighted that the economy will not need as much QE stimulus over time and if the outlook evolves as expected, purchases will be adjusted gradually. We expect the BoC to keep its forward guidance on rates unchanged; slack is expected to be absorbed, and inflation is consequently expected to return to the target on a sustained basis sometime in H2 2022. We think that the bank could continue to reduce the pace of purchases by CAD1bn each quarter, which would stop net purchases by year-end or early 2022. We expect the BoC to start hiking in H2 2022, in line with forward guidance.

- OIS implied market pricing has become more hawkish for the BoC and now shows a first hike in early Q2 2022 even as hawkish market pricing for the Fed reversed last week with the move lower in US Treasury yields. BoC hawkishness seems to be well priced-in so the announcement of another leg of tapering might not generate significant market reaction. In the medium term, we remain constructive on the CAD owing to solid domestic fundamentals, still supported oil prices on global demand recovery and a hawkish BoC.

CBA: Steady at 0.25 and tapering GoC weekly bond purchases to C$2B. CBA expects the BoC to "start increasing its policy interest rate in October 2022. We expect the stronger USD to be the dominant driver of USD/CAD this week, and see further gains as likely.

- CBA upgraded their Canadian GDP forecasts and "now forecast Canada's economy will expand by 6.3%/yr in 2021 and by 3.7%/yr in 2022.There are three major drivers of our upgrade. First, the Canadian economy has been more resilient than expected to the recent restrictions on movement. Second, US fiscal stimulus and the quick US economic recovery will boost demand for Canada's exports. Third, the vaccination drive has accelerated sharply recently. After a slow start, over half of Canadians have now received at least one dose of vaccine."
- "The BoC was one of the first central banks we monitor to taper its asset purchases in April 2021. We expect the BoC to keep tapering its weekly asset purchases until the end of 2021. We expect a subsequent tapering of $C1bn each to be announced in July 2021, October 2021 and January 2022. At this stage, we expect the BoC will start raising the cash rate in Q4 2022, probably the October meeting. The risk is an earlier start if the economy rebounds faster than expected."

CIBC Capital Markets: Steady at 0.25 and taper: reduce GoC bond purchases from C$3B to C$2B. "Trading the MPR is going to be a challenge because, on the surface, the balance of risks are asymmetric relative to current market pricing. But as we have highlighted throughout this piece, downside risks are minimal relative to the required adjustments from the April MPR. As we have said numerous times this year, we expect the CAD forwards to remain elevated. At time of writing, the pace of the Bank appears too aggressive in 2022 with nearly 3x hikes priced. If growth and inflation forecasts were seen as falling, the obvious implication would be a repricing of the front contracts that would promote a steepening of the bond curve.

- So that means it probably is not the week that forces our front-end to reprice. Practically speaking then, if the short-end doesn't reprice than the pressure is actually going to be applied locally on the 10yr sector. We would use any undue steepening to add to our core flattening positions. The taper we expect has clear implications to the net-supply build across the curve (we walk through the Taper math in detail in this report) and we see this manifesting itself in a cheaper 5s10s30s this week.

Credit Agricole: "Focus will be on the BoC policy meeting and its updated economic projections. Any indications from officials that their confidence in the economic recovery has grown since April and/or any signals of an earlier start of the bank's tightening cycle could prop up the CAD. That said, we think that any gains will likely manifest themselves mainly vs the other G10 commodity currencies."

- Back in April, the BoC surprised the markets by tapering the weekly pace of its asset purchases and further signalling an earlier start of its tightening cycle in H222. Since then, the Canadian rate markets have begun pricing in a total of almost five rate hikes by the end of 2023 more recently, with the tightening cycle starting in Q221. Despite that, USD/CAD has been on a roller coaster ride – dipping towards 1.2000 in May before rallying back towards the highs above 1.2500 last seen before the April BoC meeting. The FX spot moves deviated from the evolution of the USD-CAD rate spreads that have been moving in favour of the CAD over the same period.
- One explanation for the divergent price action in the FX and rates markets could be that the FX investors that have been piling into CAD carry trades since the April BoC meeting switched to buying USDs in the wake of the hawkish June FOMC meeting. Moreover, recent client meetings have highlighted that some market participants worry that the BoC could deliver on the already fairly hawkish market expectations. Last but not least, the prospect for tighter US and global financial conditions has undermined risk sentiment and thus the demand for carry trades, weighing on the CAD vs the safe-haven USD.

Goldman Sachs: Steady at 0.25 and tapering weekly bond purchases to C$2B. GS expects a somewhat hawkish meeting as the BoC remains "upbeat about growth on Wednesday despite slightly softer Q1 GDP data. Rapid vaccinations, strong surveys, a solid June jobs report, and a nearly 50bp easing in our Canada GS FCI since June should drive an optimistic baseline outlook, although downside risks from new strains should be in focus too.

- GS expects the output gap projections to remain "roughly unchanged .. but a large upgrade to 2021 inflation, and a focus on upside inflation risk from supply bottlenecks. Following stronger realized inflation, including in our GS trimmed core and shelter inflation measures, we have increased our inflation forecast and now expect BoC liftoff in mid-2022 (vs. 2022Q4, previously). We expect the BoC to reduce weekly asset purchases to C$2bn and to continue to project liftoff in 2022H2 on Wednesday. Although not our base case, we see a 25% probability that the BoC pulls forward liftoff to 2022H1 on Wednesday following the inflation beats."
- GS expects the MPR to "again show a strong baseline outlook although recent developments have been mixed. On the negative side, GDP grew at an 5.7% annualized rate in Q1, below the BoC's latest 7.0% projection, although Deputy Governor Lane emphasized stronger details. Globally, Delta outbreaks are raising concerns about the recovery, and our global and US CAIs have also moderated since the June meeting."

ING: Steady at 0.25 and reduction of weekly GoC bond purchases from C$3B to C$2B. Canada's economy hasn't been hit as hard as feared by the third wave of infections while the BoC's latest Business Outlook Survey showed sentiment hitting a record high on optimism that the economy can swiftly return to normality.

- With worries mounting about the implications of Canada's booming housing market and with government bond yields having dropped sharply since mid-May, we think the BoC will look to conclude the QE purchase program before the end of this year. There is questionable need for such stimulus in the current environment.
- We also expect the BoC to re-affirm its statement that they will look to hold "the policy interest rate at the effective lower bound (0.25%) until economic slack is absorbed so that the 2 percent inflation target is sustainably achieved. In the Bank's April projection, this happens sometime in the second half of 2022". We expect the language to gradually harden in coming months and expect the BoC to raise interest rate twice in the second half of 2022 with the risks skewed towards even earlier policy tightening.

JP Morgan: Steady at 0.25 and tapering weekly GoC bond purchases from C$3B to C$2B. JPM expects the BoC "will raise its growth forecasts for the second half of 2021 to shore up its annual forecasts. The Bank has signaled that decisions regarding adjustments to the pace of government bond purchases will be guided by an ongoing assessment of the strength and durability of the recovery. The upbeat news on the economic recovery has been decisive recently and supports a C$1billion taper announcement, in our view. COVID-19 trends have improved sharply nationwide and provinces are relaxing distancing rules and dropping store capacity limits. Mobility indicators are soaring as a result."

- "On inflation, the Bank has generally downplayed current price pressures as transitory, although the Bank is likely to acknowledge firming inflation expectations in the announcement. The Bank has identified the upside risks of more persistent cost pressures since the January MPR, noting that in an environment of disruptions brought on by the pandemic, alongside strong post-pandemic demand, businesses may find that they are better able to raise prices to pass along higher expenses to consumers or to rebuild their margins."

Morgan Stanley: MS expects the BoC to "proceed with its gradual process of removing policy accommodation by reducing the pace of its asset purchases from C$3bn per week to C$2bn."

RBC: "We expect the BoC to take the next step in reducing its GoC bond purchases at Wednesday's meeting. This should take them to C$2bn/week from the C$3bn/week pace announced at the April meeting. GDP has evolved roughly in line with its April MPR projection, with the increased pace of vaccinations, low COVID cases, and (safer) re-openings likely to give the BoC added confidence in the expected growth acceleration over the summer.

- With this previously factored into the BoC's (and our own) growth forecasts and no further insight on magnitude, we think there is little reason to adjust the forward guidance timeframe from the H2-2022 timing given in April (and June). Inflation has printed above BoC expectations and an upward forecast revision is likely, though BoC communication has noted that it still sees the recent spike as transitory and driven by base-effects. The BoC's focus on a broad labour market recovery should be evident, and it has previously flagged that more information on its preferred labour market indicators will be provided at the meeting."

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Scotiabank: Steady at 0.25 and reducing weekly GoC bond purchases from C$3B to C$2B. "The key is striking a balance on the magnitude of the adjustment that retains future flexibility but without signaling a greater rush that could bring forward overall exit pricing. It's feasible that a greater reduction is offered, but we err on the somewhat more cautious side since a greater reduction might compromise the desire to exit in 'gradual and measured' fashion as the BoC puts it."

- On the more hawkish tapering opinions, Scotiabank posited "reducing purchases down to, say, $1 billion in one swoop at this meeting would likely set up expectations for an end to the purchase program, perhaps at the September meeting, with pulled-forward expectations for a reinvestment phase and rate hikes. That's not inconceivable, but would signal a greater rush to exit than Governor Macklem's guidance has tended to indicate to date.
- Scotiabank offered a "potential risk in the press conference could well involve grilling Governor Macklem on potential wage-price connections. Macklem has so far leaned in favour of a fully inclusive job recovery but some mistake that as guidance he may not hike until every conceivable unemployed and underemployed worker is fully employed. Instead, a fully inclusive recovery likely speaks more toward the pace of hikes once they begin with the guidance likely to remain in favour of a starting point toward mid-year next year. I would, however, like to hear Macklem discuss his views on poor Canadian labour productivity and faster increases in unit labour costs than in the US and how this could feed into inflation risk. A discussion about labour utilization is incomplete without discussing productivity challenges relative to labour costs.

TD Securities: Steady at 0.25 and tapering weekly GoC bond purchases from C$3B to C$2B. "The outlook looks bright, but growth is likely to fall short of the BoC's lofty forecast from April. We don't expect any change in forward guidance, with the BoC still signaling that it expects economic slack to be fully absorbed (and rate hikes to occur) in 2022H2.

- "While the growth outlook has fallen modestly short of the BoC's lofty forecast from April, the CPI outlook has sharply overshot it. We look for CPI inflation for Q2 to settle at 3.4% y/y, well above the BoC's forecast of 2.9%. And while we do expect inflation to decelerate over the back half of the year, we are still forecasting Q4/Q4 inflation 3.0% versus the BoC's last estimate of 2.2%. We don't necessarily expect the Bank to revise its forecast to match ours, but clearly material upward revisions are coming — something in the neighborhood of 0.4-0.5 p.p. seems as good a guess as any. The more relevant question surrounds the outlook for 2022; we expect price pressures to moderate into the middle of next year, with CPI inflation troughing in mid-2022 at 1.9%."
- "Whatever the actual facts are of the transitory/persistent inflation debate, the Bank has repeatedly signaled that they believe inflation will moderate from here. We don't think we've seen enough data to declare a winner in this debate, so there is no reason for the Bank to change their view on the topic. Look for the Bank to cite the substantial slack still in the economy, as demonstrated by the elevated unemployment rate and wide output gap, as the major factor driving moderation in price pressures going forward.
- Putting everything together, the best course action for the BoC is to reaffirm the narrative from April: Things are improving, but there is still significant slack in the economy. Even if the BoC is having doubts about remaining on hold until 2022H2, there is absolutely no need to spook markets here (especially given that markets are pricing in 2.5+ hikes by the end of 2022). At the time of the October meeting, we should have a better sense of the persistence of the inflationary shock, the amount of pent-up demand in the economy, and prospects for a return to normal life (whatever that is). At that point, if the BoC decides that it needs to signal a change in direction, it will be standing on much firmer footing. The prudent move here for the Bank is to stall until October.

Limited policy opinions of steady at 0.25 from the following:
Commerzbank, Desjardins Financial Group, Laurentian Bank, National Bank of Canada, PNC Bank, Wells Fargo and UBS.

MNI Policy

MNI STATE OF PLAY: BOC Seen Tapering QE on Vaccine Rollout

By Greg Quinn

OTTAWA (MNI) - Canada's central bank is expected to reduce weekly bond purchases to CAD2 billion from CAD3 billion on Wednesday as mass vaccinations deliver a lasting re-opening of the economy, while transitory inflation pressures allow Governor Tiff Macklem to stick with guidance for holding a 0.25% interest rate until the second half of next year.

A potential for the solid second-half rebound the Bank of Canada has projected is becoming the dominant story as a clear majority of people have their first dose of Covid-19 vaccine, though policy makers may also note risks from variants of the virus and some weakness in the second quarter during lockdowns.

The expected taper would be the BOC's third from last year's original pace of at least CAD5 billion a week, and analysts at RBC say this one will come without any move to extend the maturity of asset purchases as was the case in one earlier round. The decision at 10am EST and press conference afterwards will be watched for indications on whether the BOC could downshift later this year to a CAD1 billion pace in line with plans to stabilize the balance sheet by reinvesting maturing assets.

Policy makers at their June decision said tapering depends on the "strength and durability of the recovery," a key phrase to watch for in this week's meeting. The reduction to CAD2 billion is expected by 12 of 13 economists surveyed by MNI, and an unchanged interest rate in all 16 responses.

Inflation forecasts may be boosted a bit in the near term to reflect the re-opening and a jump in oil prices, without changing the Bank's longer view that slack will hold down prices into next year. The BOC has said CPI will be around 3% in the next few months and later slow to 2%, while May's 3.6% pace was the fastest in a decade.

RESISTING MORE HAWKISH STANCE

"We expect the BoC to lean heavily against taking a more hawkish stance in the face of inflationary pressures," Desjardins chief economist Jimmy Jean wrote in a research note. Other economists also agree it's too soon for the BOC to signal it could again advance its guidance about lifting interest rates from the current record low, something it did in April by shifting from sometime in 2023 to the second half of next year.

For one thing, the economy remains half a million jobs short of where it could have been absent the pandemic, and June's gain of more than 200,000 jobs may not be a sustainable pace because it reflected the end of some major lockdowns.

Even with those shutdowns in April and May, economists say GDP probably still grew at a 3% annualized pace in the second quarter, close to the BOC's April prediction of 3.5%. That gap is trivial compared with fears of shrinking output around the start of the year, and GDP is now within a percentage point of its pre-pandemic level. If anything, the BOC's stance remains more hawkish than the Fed or ECB and there's no sign Macklem will dial back his relative optimism, especially with Canada's dollar relatively well behaved.

Along with a reference to the rebound's strength determining QE, it will be key to watch how Macklem adjusts his view that "with vaccinations proceeding at a faster pace, and provincial containment restrictions on an easing path over the summer, the Canadian economy is expected to rebound strongly, led by consumer spending."

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