mni

All Signal, No Noise

MARKET ANALYSIS

Bank of Canada Preview: March 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.

There is no Monetary Policy Report (MPR) or press conference following Wednesday's rate announcement, but Bank of Canada Deputy Governor Schembri will make remarks at a speech scheduled for Thursday at 1330ET. Link: https://www.bankofcanada.ca/2021/03/speech-lawrence-schembri-deputy-governor/

The next rate announcement: Wednesday, April 21, 2021 will include the quarterly Monetary Policy Report (MPR).

Point of View (POV) Holding 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. After the tide of heavy rate selling in anticipation of further improvement in global economies, the Bank will try to strike a balance between economic optimism and caution outlined in the dovish/hawkish risks below. A minority of analysts see the next policy announcement on April 21 as the more likely candidate for tweaking policy.
Dovish risk: Not at the current meeting, but a third Covid wave and resulting lockdown drag on the economy provides dovish undertones to future guidance or future announcements.
Hawkish risk: While the economic outlook has improved on balance, hiking rates after reaching and sustaining 2% inflation remains a long way off (late 2022- to 2023 est). Of the 20 sell-side analyst opinions outlined below, none expect a change in the target rate Wednesday, while half see no change in for the next two years.

mni Central Bank Watch - Bank of Canada

March 09, 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	0.7	↑	0.1	↑					-0.36
Core CPI - Median	% y/y	2.0	2.0	→	1.8	↑					1.06
Industrial Product Price	% m/m	2.0	0.0	↑	1.1	↑					1.41
Breakeven 10-Year	%	1.76	1.32	↑	1.31	↑					1.86
Economic Activity		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
PMI Manufacturing	Index	54.8	55.8	↓	55.1	↓					0.80
GDP	% m/m	0.1	0.8	↓	6.2	↓					-0.91
Manufacturing Sales	% m/m	0.86	2.04	↓	23.14	↓					-0.54
Trade Balance	CAD bn	1.41	-3.90	↑	-2.54	↑					2.16
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	11.59	15.59	↓	16.29	↓					0.39
Bank Lending Survey (Q)	% m/m	-3.03	7.28	↓	19.16	↓					-0.40
New House Prices	% m/m	0.7	0.8	↓	0.4	↑					0.37
Housing Starts	K	282.4	227.1	↑	245.1	↑					1.60
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	-3.4	1.6	↓	22.2	↓					-0.90
Retail sales Ex-Autos	% m/m	-4.1	1.7	↓	15.2	↓					-1.16
Employment Chge m/m	K	-212.8	94.4	↓	416.9	↓					-1.24
Ave Hourly Wage Rate	% y/y	5.65	5.25	↑	5.66	↓					0.03
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	18458	17190	↑	16514	↑					1.76
Canadian 10-Year Yield	%	1.53	0.67	↑	0.62	↑					2.23
CAD Yield Curve (2s-10s)	bps	124.0	42.0	↑	34.7	↑					2.05
CAD TWI	Index	124.07	120.08	↑	119.70	↑					1.14

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

Analyst Views

Bank of America: Steady at 0.25, as are QE purchase and forward guidance expectations. BoA thinks the BoC "will have to acknowledge much better growth than it anticipated in the US and at home" while the BoC "will try to do so without pushing back on the recent fierce movement in rates, just as the Fed has been doing."

- One way to do so is to emphasize that substantial accommodation will remain until the recovery is well advanced and that for now short-term risks remain to the downside. But it will be difficult to strike the right balance and, hence the risk is that the BoC sounds too constructive. The BoC said in January that it will adjust the pace of bond purchases as required as it gains confidence in the strength of the recovery, and we may be getting close to that point. Our baseline is tapering not until end-2021 or beginning-2022, but risks are building for earlier tapering. Risks look skewed hawkish for rates and FX.

Barclays: Also expects steady rate at 0.25, along with QE purchase and forward guidance expectations with an optimistic tone on the medium-term outlook. Market pricing of earlier hikes for the BoC have picked up dramatically, which is inconsistent with the forward guidance provided by the bank.

- Despite some expectations of early tapering and hikes by the BoC built in, we expect the front-end yields to consolidate. The BoC Governor reiterated accommodation for longer, especially as the recovery process will remain choppy until broad immunity is reached. The BoC would like to see indications of sustained recovery before they start withdrawing stimulus, which is still some time away. GDP data last week showed that the economy ended 2020 on a solid footing. If incoming data continue to show resilience to the second COVID wave and indicate that the recovery is well underway, the BoC might start to firm its language and guide markets toward an eventual reduction of easing at the April meeting, when it updates it projections in the Monetary Policy Report.
- On Deputy Thursday's speech, Barclays said Governor Schembri is likely to attribute the move in long-end rates to growing optimism for a quick recovery due to robust vaccine rollout while emphasizing that it will take some time to get to complete recovery so the economy will continue to require support in the interim. We also get the employment report for February (Friday), and it should indicate the labor market bouncing back alongside easing restrictions.

CBA: "The Bank of Canada (BoC) is not expected to make any policy changes on Wednesday. The policy meeting precedes what is expected to be a weak February labour market report (Friday)."

CIBC Capital Markets: Steady at 0.25. The Bank of Canada will leave rates unchanged, citing a huge gap to full employment and sustained (no tone-time) inflation pressures, so the focus will be on whether they hint at a tapering in bond purchases after April, and how far they go in adjusting their description of the economy given upside surprises in recent data. If that mixed message gets misinterpreted, Deputy Governor Schembri will have the opportunity to correct market perceptions in remarks the following day.

- January's very weak jobs reading seemed out of synch with the hefty gain in the flash GDP estimate for that month. So for that reason alone, a decent rebound in February would be logical, and some regions also had opened parts of the service sector as well. We will still have a huge hole to fill in the labour market, and we're not yet far enough in the vaccine process to see much of a recovery in sectors related to tourism or live entertainment, and the "reopening" in food service is still only a partial one.

Citigroup: Steady at 0.25. Citi analysts do not expect any shift in policy or substantial shift in messaging at this week's BoC meeting that is likely to feature a more optimistic policy statement but still expressing caution over possible downside risks. Citi analysts' base case is for a C$3bn-per-week asset purchase pace through July, C$2bn from July to October, and C$1bn from October through the end of Q1-2022.

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Credit Suisse: Steady at 0.25. The BoC will likely keep rates near zero as the economic recovery broadens. The GDP level should remain far below the potential level throughout most of 2021, enabling the bank to look through temporary inflationary pressure. However, asset purchases will likely be revamped if economic growth or market conditions falter.

Goldman Sachs: Steady at 0.25. Goldman Sachs expects "policymakers to stick to the guidance to hold the policy rate at the lower bound until inflation sustainably reaches 2% and slack is fully absorbed. The statement will likely also repeat that liftoff does not happen until 2023 in the Bank's January projections."

- GS does not expect the BoC to alter the following hint at tapering from the January statement: "As the Governing Council gains confidence in the strength of the recovery, the pace of net purchases of Government of Canada bonds will be adjusted as required." While a stronger tapering signal in response to the positive growth developments and policymakers' concern about owning too large of a share of Canada government bonds (the BoC share has risen to nearly 40% of outstanding bonds) is a hawkish risk, we expect policymakers to wait a bit longer following recent FCI tightening.

ING: A rebounding economy, rising inflation expectations, oil prices giving fresh recovery hopes to the battered Canadian energy industry and contained contagion numbers would all argue in favour of starting to unwind QE. Indeed, we think, and consensus appears to be on the same side, that the next move by the BoC will be to taper its bond purchases.

- In the middle of a fierce bond sell-off, Governor Tiff Macklem will likely have no interest in endorsing any tapering expectations. We expect the BoC message to be broadly in line with the recent Fed's rhetoric: stressing that monetary stimulus is here to stay. This means that the market (and FX) impact should be limited, unless Macklem opts for a more alarmed rhetoric (i.e. verbal intervention) on the volatile bond environment.

Laurentian Bank: Steady at 0.25. **"**There has been too much talk about the micro-cuts earlier in 2021, particularly since confidence improves relative to the outlook. Furthermore, the pass-through of changes in the policy rate near the zero bound is more limited as shown in Scandinavian countries, making the case for an indeed lower bound than 0.25% not very meaningful in the grand scheme of things."

JP Morgan: Steady at 0.25. JPM "does not expect any change to the forward guidance regarding the policy rate, and we do not expect the Bank to announce any change to the QE program on Wednesday. We look for the Bank to hold the policy rate on hold until 2023 and expect the Bank will begin to taper asset purchases in the second half of 2021 when the uncertainty around a sustained economic economy has lifted. There will be no new Monetary Policy Report so no updated economic forecasts (that will come in April). However, the Bank is likely to note in the announcement that fourth quarter growth in 2020 was significantly stronger than forecasted in the January MPR and that first quarter growth is now tracking a gain instead of a decline as forecasted."

- Governor Macklem very recently stressed that Canada is projected to experience a protracted recovery and will need exceptional monetary support for a considerable amount of time. The provinces are just coming out of their strict containment measures, and we believe the Bank will continue to be cautious through the first half about withdrawing stimulus. We think it's notable that governor Macklem said in his last press conference that "we want to see a strong rebound." We generally believe that the April meeting is too early for an attention-grabbing announcement of asset purchase tapering, but we will be looking for any strong signals in the March announcement that the Bank may be pivoting in its view.
- On the backup in yields, the Governor has pinned market optimism on the success of monetary and fiscal policy stimulus combined with the rollout of vaccines. As in the U.S., inflation expectations have moved back up recently on the confidence that central banks, including the Bank of Canada, are going to get inflation back to target. Governor Macklem has said "that's a good thing."

Morgan Stanley: Steady at 0.25. MS expects the BoC's "March statement (and comments from Deputy Governor Schembri's Economic Progress Report) to reflect the improving outlook for the Canadian economy, but not to signal any meaningful change in policy stance. We suggest using any resulting CAD weakness to add to CAD longs."

National Bank of Canada: Steady at 0.25, Although the epidemiological situation has improved in the country, we expect the central bank to maintain an accommodative bias. The policy statement is once again likely to mention downside risks to the economic scenario, such as a possible third wave of infections/restrictions, and lingering uncertainties regarding vaccines rollout. The Bank will have no choice but to acknowledge faster-than- anticipated growth in Q4, but this admission could be counterbalanced by a reminder of the weak employment situation in the country.

- In this context, the BoC should keep interest rates unchanged. As for the asset purchase program, it should remain fixed at C$4 billion per week for now. We anticipate the program to be downsized to C$3 billion in April, when the Bank will have more visibility about the strength of the post-lockdown recovery. Note that the policy announcement will not be followed by a press conference. We should nonetheless get more details about the BoC's thought process on the following day, when Deputy Governor Lawrence Schembri delivers a speech to Restaurants Canada.

RBC: No change in policy. This means no change in the overnight rate (0.25%), GoC bond purchases (C$4bn/week), and forward guidance timeframe (in 2023). GDP growth came in well above the BoC's January MPR projection in Q4 (9.6% annualized vs 4.5%) and is tracking into positive territory in Q1 as well (vs. -2.5% in the January MPR).

- The BoC is very likely to acknowledge the stronger growth, though it may temper this given continued concerns about labour market scarring. Improved vaccine distribution of late is likely to reinforce the BoC's (and our own) expectation for accelerating growth through 2021 on a reopening economy and elevated household savings levels. Overall, we expect that the BoC will have the confidence to announce a taper in its GoC bond purchases at the meeting (and MPR) on April 21. The usual Economic Progress Report will be given on March 11 by Deputy Governor Schembri.

Scotiabank: Steady at 0.25. No major policy shifts are expected, but markets will be on watch for possible action or clues toward tactically adjusting bond purchase program parameters. The April 21st Bank of Canada communications will offer more of a chance at a fuller narrative reset as it will be accompanied by a full forecast update. Markets haven't had a forecast update from the BoC since the January meeting and a lot has happened since then, so a thorough re-take is in order.

- For one thing, growth has been utterly smashing BoC expectations. Q4 GDP growth of 9.6% doubled the BoC's forecast. Further, it while the BoC had been forecasting a -2.5% contraction in Q1 GDP, growth is instead tracking between +3% (straight data to date) and +5% (Scotia's 'nowcast') depending on the methodology employed.
- The BoC's control over short-term market rates has once again come under renewed pressure of late. The Canadian Overnight Repo Rate Average (CORRA) has slipped further beneath the BoC's 0.25% overnight rate target. A major driver of this is excess liquidity being pumped into the market by the Bank of Canada's purchase programs relative to the decline in issuance.

TD Securities: Steady at 0.25. The BoC's best course of action is to say as little as possible. They will need to acknowledge the improving outlook, and they have no incentive to endorse recent shifts in BoC expectations. Best to emphasize uncertainty and leave all options on the table for April. If the BoC manages to strike the proper balance between optimism and caution, we could see a slight retracement in rates - but the balance of risk skews towards further selling.

Limited policy opinion to steady at 0.25 from the following:
Bank of Montreal, Desjardins Financial Group, Deutsche Bank, Wells Fargo and UBS.

MNI Policy

MNI STATE OF PLAY: BOC May Press QE as Market Seeks Taper Clue

By Greg Quinn

OTTAWA (MNI) - The Bank of Canada on Wednesday may signal another taper of asset purchases is coming at its April meeting, some investors say, while keeping QE steady for now and stressing that the economy needs time to rebound and pull inflation to target even after some recent gains.

Governor Tiff Macklem will hold the overnight target interest rate at 0.25% in a decision due at 10am EST, according to all 15 economists surveyed by MNI. All nine economists who made a prediction said the pace of asset purchases will continue at a minimum CAD4 billion a week.

Macklem told MNI Feb. 23 his main focus is economic slack and not the bond market's bet on a burst of inflation, and his QE actions will be guided by his view inflation won't stabilize at a 2% target until into 2023. The governor also told MNI he's concerned the Canadian dollar's strength could become another drag on growth.

The shorter one-page statement for this meeting, ahead of April's decision that will contain a much larger quarterly economic forecast paper, gives Macklem wiggle room to gloss over January's strong 0.5% GDP gain and progress obtaining vaccines. It's also ahead of the February CPI report that could be the first to show inflation picking up as gasoline prices jump following last year's swoon.

MACKLEM INTERVIEW

Macklem also told MNI last month that while he has the tools to brake inflation if needed, he doesn't see that as a likely scenario. The last rate decision also said that as confidence in the rebound grows, policy makers could adjust the pace of QE again, and the BOC's standing guidance has been to keep asset purchases going until the recovery is well underway.

"While a March taper would, in our view, be inconsistent with BoC messaging, we still see it as a non-trivial possibility," National Bank Financial rates strategist Taylor Schleich wrote in a research note.

Markets are signaling greater expectations of inflation and perhaps a tightening of QE, with Canada's dollar strengthening 6% over the last year and 10-year federal bond yields doubling to about 0.9% over the last two months.

While Macklem may need to upgrade his January estimate that GDP contracted at a 2.5% annualized pace in the first quarter, even flipping it to a small gain likely won't signal the economy is running hot with inflation at 1%, the bottom of the BOC's target range. GDP remains 3% below pre-pandemic levels.

OWNING HALF THE MARKET

"I'm confident we have the tools to control inflation. We're more worried about inflation being too low than too high," Macklem said in the MNI interview. "If you saw inflation expectations starting to go way up well above target, that would be a different story."

Arguments for tapering also rest on investor arguments the BOC must avoid buying up more than half of federal bonds, which could happen by year-end. Finance Minister Chrystia Freeland has yet to present a budget for a fiscal year that starts in April, meaning there's still no clarity on future debt auctions.

The BOC already slowed QE in October from the original pace of at least CAD5 billion a week set last March, while also extending the maturity of assets purchased. Macklem said in January that QE is needed for a while and scaling back "will be a gradual process.

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