Bank of Canada Review: December 2020

As expected, the Bank of Canada left the target rate on hold at 0.25% (for the sixth consecutive time), while holding QE steady after extending duration/reducing size of purchases at the October policy announcement. Recent Covid vaccine developments provided some positive news but inventory and wide-spread distribution remains will take well into 2021 to reach a majority of Canadians, tempering forward expectations.

There was no Monetary Policy Report or press conference following Wednesday's rate announcement, but Deputy Governor Paul Beaudry will present the Economic Progress Report "Our quantitative easing operations: Looking under the hood" via video conference on Thursday at 1330ET (media Q&A at approximately 1450ET).

Relevant Links

Policy Announcement:
https://www.bankofcanada.ca/2020/12/fad-press-release-2020-12-09/

Thursday's Economic Progress Report:
https://tinyurl.com/y6tbrqot

Bank of Canada 2021 Policy Schedule:

Wednesday, January 20*
Wednesday, March 10
Wednesday, April 21*
Wednesday, June 9
Wednesday, July 14*
Wednesday, September 8
Wednesday, October 27*
Wednesday, December 8
*Monetary Policy Report published

Reminder of implementation adjustment: according to the Bank of Canada site, "starting in 2021, the target for the overnight rate will take effect on the business day following each rate announcement. This differs from the Bank's current approach, whereby Governing Council rate decisions apply immediately upon release. The Bank is also reviewing the publication time of its interest rate announcements, which is currently 10:00 (ET). Any changes resulting from this review will be communicated in due course.

Bank Of Canada December 9, 2020 Policy Statement

The Bank of Canada today maintained its target for the overnight rate at the effective lower bound of .25 percent, with the Bank Rate at .5 percent and the deposit rate at .25 percent. The Bank is maintaining its extraordinary forward guidance, reinforced and supplemented by its quantitative easing (QE) program, which continues at its current pace of at least $4 billion per week.

The rebound in the global and Canadian economies has unfolded largely as the Bank had anticipated in its October Monetary Policy Report (MPR). More recently, news on the development of effective vaccines is providing reassurance that the pandemic will end and more normal activities will resume, although the pace and breadth of the global rollout of vaccinations remain uncertain. Near term, new waves of infections are expected to set back recoveries in many parts of the world. Accommodative policy and financial conditions are continuing to provide support across most regions. Stronger demand is pushing up prices for most commodities, including oil. A broad-based decline in the US exchange rate has contributed to a further appreciation of the Canadian dollar.

In Canada, national accounts data for the third quarter were consistent with the Bank's expectations of a sharp economic rebound following the precipitous decline in the second quarter. The labour market continues to recoup the jobs that were lost at the start of the pandemic, albeit at a slower pace. However, activity remains highly uneven across different sectors and groups of workers. Economic momentum heading into the fourth quarter appears to be stronger than was expected in October but, in recent weeks, record high cases of COVID-19 in many parts of Canada are forcing re-imposition of restrictions. This can be expected to weigh on growth in the first quarter of 2021 and contribute to a choppy trajectory until a vaccine is widely available. The federal government's recently announced measures should help maintain business and household incomes during this second wave of the pandemic and support the recovery.

CPI inflation in October picked up to 0.7 percent, largely reflecting higher prices for fresh fruits and vegetables. While this suggests a slightly firmer track for inflation in the fourth quarter, the outlook for inflation remains in line with the October MPR projection. Measures of core inflation are all below 2 percent, and considerable economic slack is expected to continue to weigh on inflation for some time.

Canada's economic recovery will continue to require extraordinary monetary policy support. The Governing Council will hold the policy interest rate at the effective lower bound until economic slack is absorbed so that the 2 percent inflation target is sustainably achieved. In our October projection, this does not happen until into 2023. To reinforce this commitment and keep interest rates low across the yield curve, the Bank will continue its QE program until the recovery is well underway and will adjust it as required to help bring inflation back to target on a sustainable basis. We remain committed to providing the monetary policy stimulus needed to support the recovery and achieve the inflation objective.

MNI Policy Reviews

BOC May Bring More Vaccine Optimism in January

By Greg Quinn

OTTAWA (MNI) - The Bank of Canada may be saving some of its optimism about Covid vaccine breakthroughs for the next policy meeting in January, when it will also deliver a wider forecast paper, CIBC Senior Economist and former central bank researcher Royce Mendes told MNI.

The next Monetary Policy Report may focus an upgraded GDP forecast on 2022, because the 2021 expansion may be curbed by tighter health restrictions imposed in recent weeks, Mendes said in an interview. Earlier on Wednesday the central bank took note of progress on vaccines and said in the near term the global and domestic economy face volatility from the second wave of Covid-19.

Canada this year has shown resilience including the bounce-back from the spring lockdown that defied worst-case projections. That also suggests less need to embrace dire scenarios about "scarring" over a longer period, he said.

"I wouldn't be surprised if the tone of the next MPR sounded a little more optimistic," said Mendes, who at the BOC was a foreign reserve portfolio manager and principal researcher in the financial markets branch. "The big change since October is just feeling like there is an end to these crazy times now, and that will show up I think in various ways in the next forecast."

The BOC's October MPR:https://www.bankofcanada.ca/wp-content/uploads/2020/10/mpr-2020-10-28.pdfpredicted 4.2% growth in 2021 and 3.7% in 2022, following a 5.7% drop this year, while CIBC projects a 5.1% burst in 2022.

--CONSUMER-LED RECOVERY

Governor Tiff Macklem on Wednesday affirmed he won't raise the 0.25% policy rate before 2023 and QE of at least CAD4 billion a week until the recovery is well underway. That announcement came hours before Canada approved its first coronavirus vaccine, a development that pressures policy makers to advance their assumption one would be widely in use by mid-2022.

While the BOC has to be cautious so long as Covid infections continue, monetary policy is also being supported by strong fiscal policy, Mendes said. Canada's budget deficit is the highest as a share of GDP since World War II, and one of the largest among major economies.

"You should clearly expect that things like consumption are going to be major drivers of the economic recovery," he said. "Starting in the second quarter, you should start to see consumption, they might talk about it."

Given that dominance, the BOC statement's reference to a strong dollar amid low exported commodity prices is unlikely to be an overriding concern, Mendes said. "There's not a lot they can do," to fight it, he said.

--CALIBRATING QE PROGRAM

The BOC added hints that optimism won't turn radical, such as noting growth may be weak in the first quarter, and saying it retains the right to keep recalibrating its CAD4 billion a week of QE, Mendes said. Policy makers in October scaled back QE from CAD5 billion while shifting purchases to longer-term assets, saying the actions would provide just as much support. Governor Macklem has also downplayed concerns that owning even half the government bond market would be a major problem.

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"At some point in 2021, they are going to have to again recalibrate this program," Mendes said. "They are talking about the room that they have to further stimulate the economy with regards to the QE program, and maybe that is a bit of a push back against the expectation that it has to wind down simply because of the size of the program."

Sell-Side Analyst Reviews:

BMO: The Bank of Canada held policy rates steady at 0.25% and left the QE program unchanged, as expected. The overall tone of the statement remained cautious, not surprisingly, given the still-wide output gap and with the country in the middle of a second wave of the virus. There were a few notes of optimism with some discussion of the positive vaccine news. Recall that the October MPR assumed a vaccine wouldn't be widely available until mid-2022. The current headlines suggest we'll get something much sooner, which points to a faster economic recovery. Indeed, the final paragraph repeats the 2023 timeline for slack to be absorbed and inflation to be sustainably at target, but there's an added caveat that the projection is from the October MPR, suggesting the timeline could change in the January MPR. Hopefully we'll have more clarity around vaccine delivery dates by then. Another positive for the outlook is the additional fiscal stimulus announced last week..."The federal government's recently announced measures should help maintain business and household incomes during this second wave of the pandemic and support the recovery."

- While the longer-term outlook has brightened, the near-term has become more challenging. The BoC sees the economy as having more momentum heading into Q4, but the second wave of infections "can be expected to weigh on growth in the first quarter of 2021." Hard to argue with that point with restrictions tightening across much of the country in recent weeks. The end date for those restrictions will heavily impact Q1 growth as well (positively or negatively), though it's clear the handoff from December will be soft.
- Key Takeaway: Despite a seemingly more upbeat medium-term outlook amid positive vaccine news, the BoC remains committed to providing "extraordinary monetary policy support". That means rates will stay at the effective lower bound until "economic slack is absorbed so that the 2 percent inflation target is sustainably achieved." And, QE will continue "until the recovery is well underway." There's a light at the end of the pandemic tunnel, but it's still pretty far away.

Citigroup: The Bank acknowledges optimism on the back of the vaccine development however notes "the pace and breadth of the global rollout of vaccinations remain uncertain" and highlights the re-imposition of restrictions on the back of virus second wave "can be expected to weigh on growth in the first quarter of 2021 and contribute to a choppy trajectory until a vaccine is widely available." This aligns with the risks heading into the meeting which leaned slightly dovish on the back of virus second wave induced restrictions and currency strength.

- USDCAD should continue to trade in line with the broad USD move. There are some support levels here from late 2018 lows which may help tame the recent selloff. However, our Techs team notes the pair broke through key trendline and moving average levels in recent weeks suggesting a retest of the 2017 lows (1.2062)."

Goldman Sachs: The Bank of Canada turned "slightly more upbeat on inflation, now expecting slack to weigh on inflation 'for some time' vs. 'throughout the projection horizon'' previously. The statement left forward guidance unchanged, as expected, but noted that QE aims to 'keep interest rates low across the yield curve' until the recovery is well underway. We believe the BoC could meaningfully upgrade its growth and inflation projections at the January 20 meeting. At the same time, the 'keeping rates low' language signals ongoing focus on preventing a premature tightening in financial conditions."

- The BoC took confidence from recent positive vaccine and fiscal news, moments before Health Canada authorized the Pfizer-BioNTech COVID-19 vaccine with conditions (0.25 million doses expected by year-end). The BoC noted that vaccine development "is providing reassurance that the pandemic will end" while noting uncertainty around the rollout. Our baseline expectation is that 50% of the Canadian population will be vaccinated by April.
- The BoC, however, expects rising infections and restrictions to "weigh on growth in the first quarter of 2021 and contribute to a choppy recovery until a vaccine is widely available". As expected, the statement also noted recent federal fiscal relief and higher oil prices as well as "a further appreciation of the Canadian dollar." Despite virus resurgence, the accelerated vaccine timeline, and positive fiscal news from Canada (and potentially soon in the US) indicate notable scope for upgrades to the BoC growth projections in the January 20 Monetary Policy Report (MPR).
- The statement noted that the inflation outlook remains in line with the October MPR projection and that core inflation measures all remain below 2%. The Bank did turn slightly more upbeat, however, now expecting economic slack to weigh on inflation "for some time" compared to the expectation that it will remain below target "throughout the projection horizon" previously.

ING: It was always a long shot to expect changes at today's Bank of Canada policy meeting so it comes as no surprise they decided to leave their stance unchanged. After all, it was only in October they announced a "recalibrated" quantitative easing programme through shifting asset purchases towards the longer end of the yield curve while lowering the weekly purchases from "at least C$5bn" to "at least" C$4bn.

- Back then they also provided forward guidance saying the policy rate will stay at the effective lower bound (0.25%) until the 2% inflation target is "sustainably achieved", which in their forecasts won't happen until 2023. All of these viewpoints and policy actions were restated in today's announcement.
- The argument for the October change was household and corporate borrowing costs tend to be more influenced by longer-term government borrowing costs, so by focusing spending there they could flattening the yield curve, giving them more bang for their buck. They reduce their weekly asset purchases without any tightening of monetary conditions - in their view.
- The second wave poses real risks: In terms of the economic outlook, while there is the prospect of a vaccination programme, the near-term news surrounding Covid-19 is deteriorating as cases and hospitalisations jump. Restrictions are coming in and that is already starting to weigh on sentiment and activity with the improvements in employment showing signs of losing momentum.
- The BoC warned that "new waves of infections are expected to set back recoveries in many parts of the world" while in Canada specifically they suggested the situation will "weigh on growth in the first quarter of 2021 and contribute to a choppy trajectory until a vaccine is widely available".
- Many positive factors have been falling in the right place for CAD over the past few weeks. Risk sentiment has remained upbeat thanks to vaccine advancements, oil prices off lows, and robust "Canadian jobs market continues to outpace the US."

JP Morgan: Noteworthy in today's announcement was a brief discussion of the near-term growth outlook. The statement notes that "Economic momentum heading into the fourth quarter appears to be stronger than was expected in October." With record-high cases of COVID-19 in many parts of Canada and renewed restrictions on activity, the Bank now appears to expect more of a negative impact on growth in the first quarter of 2021, which is more aligned with our forecast. Our forecast for current-quarter real GDP growth is 3%q/q, ar followed by a growth stall in 1Q21. We expect a robust pickup in real GDP growth from 2Q21 onward. On inflation, the Bank affirmed that higher prices for some food items had led to a slightly firmer track for inflation in the current quarter. Nevertheless, the Bank's three measures of core inflation all remain below 2%, and considerable economic slack was expected to weigh on inflation for some time.

RBC: There are a number of recent developments that, on balance, argued for a steady hand from the BoC: Rising case counts and renewed restrictions: The BoC's Q4/20 GDP growth forecast (+1% annualized) was already fairly conservative, so we don't see substantial scope for disappointment in the current quarter. The bank acknowledged extended restrictions could mean some downside risk in Q1/21—and growth in the past quarter was already a bit short of the BoC's expectations. Overall, the recent/near-term growth backdrop looks a bit less solid than the BoC was assuming in October, but the policy statement wasn't overly downbeat in that regard.

- Vaccine news: The BoC assumed the pandemic would run its course by mid-2022, so the imminent rollout of effective vaccines (likely ramping up through the first half of next year) suggests upside risk to the pace of recovery in 2021 and 2022. The bank didn't go that far in today's statement, simply saying recent news "is providing reassurance that the pandemic will end and more normal activities will resume," but with the caveat that the timing and pace of vaccine rollout remains uncertain. Even taking near-term challenges into account, we think a steeper growth profile beyond Q1/21 will see economic slack absorbed sooner than the BoC assumed in October. The BoC didn't get ahead of itself, though, with forecast revisions having to wait until January.
- Fiscal policy: Government support for households and businesses has been extended well into next year, which the BoC said should help maintain incomes during the second wave and support the recovery. The BoC and other central banks have consistently argued governments are better placed to manage the economic impact of the pandemic, and ongoing fiscal support (including potential stimulus spending as the recovery progresses) reduces pressure on the BoC to do more.
- Overall, we think vaccine news provides more than enough light at the end of the tunnel for the BoC to look through any modest growth disappointments stemming from the second wave. Without updated forecasts, though, it's not surprising that the BoC was guarded in its optimism today. There's still a long way to go in the recovery—Q3 GDP was 5.3% below pre-pandemic levels, worse than the decline seen in 2008/09. The bank reiterated that its October forecasts didn't envision economic slack being absorbed until 2023. Updated forecasts in January should move that timeline forward into 2022.

TD: The Bank of Canada did not rock the boat at the December meeting, with no change to the overnight rate or QE, and no material change to forward guidance. The Bank struck a balanced tone on recent developments, downplaying both the weaker-than-expected Q3 GDP numbers and the stronger recovery in CPI.

- The key takeaway from today is that the Bank sees things evolving largely as expected and appears comfortable with the amount of stimulus currently in place. There is still considerable uncertainty surrounding the outlook, but the Bank is unlikely to say too much ahead of the January policy decision & MPR.
- Rates: Rates markets looked past the BoC decision as it contained no new guidance on tapering or the outlook. We continue to favour 10s30s steepeners.
- FX: The BoC's take on the loonie validates our view that global themes and trends are driving nearly all assets with growth, value, and mean-reversion the key drivers for FX. The USD is still stretched on short-term drivers and as such we expect some consolidation into year-end that would support another push through 1.30.

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