

Bank of Canada Review: July 2020

Relevant Links :

Policy Announcement:

<https://www.bankofcanada.ca/2020/07/fad-press-release-2020-07-15/>

Monetary Policy Report:

<https://www.bankofcanada.ca/2020/07/mpr-2020-07-15/>

Policy Press Conference: with Tiff Macklem and Senior Deputy Governor Wilkins:

<https://www.bankofcanada.ca/2020/07/opening-statement-150720/>

BOC rates seen being on hold into 2023 after Gov Macklem says it will remain 0.25% until inflation is sustainably around 2% target.

- Macklem also said that QE may be tapered off before rates rise, in line with earlier plan to buy at least CAD5b/wk of federal bonds until recovery is well underway. - "We will be looking for signs that the recovery is becoming more self-sustaining," Macklem said at press conference. "Logically yes, the recovery being well under way comes before capacity has been fully absorbed, but those of those are some ways off."

- "We continue to think asset purchases will continue at least through the first quarter of 2021, and likely well into next year," RBC senior economist Josh Nye says in note. No rate rise until 2023 or later.

- Capital Economics: "Bank signals it will not raise rates until at least 2023."

- "The timing of the first BoC hike could be similar to that for the Fed, in early 2023," CIBC chief economist Avery Shenfeld said. "the phrase "well underway" also suggests that QE will end before the policy rate is hiked.

Analyst Views

Bank of America: "Low rates for a long, long time." BoA expects the "policy rate to remain at current levels for many quarters and see QE stepped up if needed. The statement maintains a relatively upbeat tone and says the economy likely hit bottom in April, in line with our view that Covid-19 containment is allowing the Canadian economy to avoid the worst case scenario."

- "The July Monetary Policy Report (MPR) has inflation below 2% through the BoC's forecast horizon (2022), so the new forward guidance is effectively saying the BoC is ready to keep the overnight rate target at the effective lower bound for years. We have inflation returning to 2% next year, but the key is that even in that case the BoC would still wait to see that inflation is 'sustainably' at the 2% target. Sustainably achieving the target will likely take a long time given the large contraction in economic activity and that Covid-19 is still on the loose in the US and other countries. So the BoC's message is that rates will remain low for a long, long time, so that monetary stimulus will continue to support the recovery."

Bank of Montreal: Lower for longer under Macklem's direction. "The policy statement stresses the extreme uncertainty still clouding the outlook, with the Bank providing a 'central scenario' rather than the usual growth and inflation projections. The scenario has Canadian GDP contracting 7.8% in 2020, then rebounding 5.1% in 2021 and 3.7% in 2022. GDP doesn't return to pre-COVID levels until 2022."

- BMO's "forecast is less negative than the BoC's, with a 6% drop in 2020 before a 6% rebound in 2021. We also expect GDP to return to pre-COVID levels around the end of 2021/early 2022."

Capital Economics: "While the tone of the statement was cautiously upbeat given the economy has avoided the worst-case scenarios that the Bank feared during the height of the crisis, the key change was the commitment to "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".

- "Based on the Bank's new forecasts, this implies it has no intention of raising policy rates for several years."

CIBC: The BoC's "central economic forecast is qualitatively similar to our own, although somewhat more pessimistic in terms of growth through 2021. These days, given the margin of error and the size of the swings, the fact that the BoC's call is below ours by a bit over a half percent in each of the next two years isn't really that material. Some of the gap might owe to the BoC's more pessimistic take on the US for 2020 than the one we published in mid-June, with the very recent news on the virus likely weighing on its assessment."

- "While potential output will recover as disruptions clear out, its path will be lower than the pre-recession outlook, capturing weaker capital spending, reduced immigration, permanent business closures and skills mismatches for displaced workers."

Citi: "Slightly Dovish. The BoC as expected, acknowledging the better data but notes the 'timing and pace of the recovery' will remain vulnerable to virus risks. They reemphasize their commitment to provide 'extraordinary monetary policy support ... until economic slack is absorbed so that the 2 percent inflation target is sustainably achieved,' which is slightly more aggressive than the previous statement."

- "One of the more interesting notes in the MPR deals with the new 'Analytical price index' which incorporates high frequency data on consumption patterns to calculate inflation and 'Overall, this adjusted index suggests slightly less downward pressure on inflation than CPI does, by about 0.3 percentage points in May'."

Desjardins: "Given the major difficulties facing Canada's economy, monetary policy will have to be very accommodating for an extended period of time. Today, the BoC committed itself to maintaining its key rates at their floor until surplus capacity has been absorbed, which will in all likelihood take many quarters." **ING:** "While noting signs of improvement, the Bank of Canada has emphasised that policy will remain ultra accommodative for a number of years. This means short rates pinned to the floor and longer dated yields staying depressed. This suggests the BoC will play second fiddle to other short-term drivers of CAD: global sentiment, oil and US virus cases."

- "The press release underlines the sense of uncertainty with the central bank presenting a central scenario based on there being no second Covid wave. This concludes that the most likely outcome is a 5% contraction in the global economy over the course of 2020 before rebounding 5% in both 2021 and 2022 with the risks tilted to the downside given the potential for a resurgence in infections."

JP Morgan: "The Bank has made it unusually clear that interest rates in Canada will be low for a very long time. Governor Macklem remarked during the press conference that the Governing Council discussed the full range of the extended toolkit—forward guidance, the size of QE, yield curve control—before settling on outcome-based forward guidance. On QE, the governor and the deputy governor emphasized that the Bank has committed to buying a minimum of C\$5 billion per week of Government of Canada bonds. The Bank strongly reiterated that QE will continue until the recovery is well under way."

National Bank of Canada: "Overall, while there weren't many changes to Bank of Canada policy, the statement and accompanying MPR reads somewhat dovish to us as Macklem has made it abundantly clear that the policy rate is going to remain anchored at the effective lower bound for "a long time". There weren't any changes to the quantitative easing program but we fully expect this to continue at least through the current fiscal year and likely well beyond. Further, the introduction of more explicit forward guidance reinforces that the policy rate will be on hold for a long time, as the Bank's current central scenario doesn't have inflation reaching 2% in its projection horizon through 2022."

RBC: "Forward guidance suggests no rate hike before 2023; Pandemic doing long term damage to Canada's economy. The bank did deploy an additional policy tool: forward guidance. Governing Council is pledging to keep the overnight rate at its current level until the economy is back at full capacity and inflation is sustainably at the bank's 2% target. Based on economic projections in the MPR, that won't be until 2023 or later. By reducing expectations of future short-term interest rates, this forward guidance is intended to keep longer-term borrowing costs low—a goal that is supported by ongoing asset purchases. As Governor Macklem clearly stated the bank wants Canadians to know that borrowing costs will remain low for a long time."

- "While the bank provided more specific guidance on the path of the overnight rate, it maintained its relatively vague guidance that asset purchases will continue until the recovery is "well underway". Governor Macklem provided a bit of additional clarity, saying the bank wants to see evidence that the recovery is becoming self-sustaining before easing up on QE. We continue to think asset purchases will continue at least through the first quarter of 2021, and likely well into next year."

Scotiabank: "A Policy Rate Hold Until 2023+. Whether it is a repudiation of the prior regime's tendency to loathe forward rate guidance, or simply a sign of the times given a massive shock to the system is not clear. What is clear is the BoC's guidance that you can count on the policy rate to be left at 0.25% probably into 2023 if not later. Governor Macklem fully embraced forward rate guidance as I indicated he would immediately after his appointment was announced and in the preview of this meeting."

MNI Policy Review

Macklem Bests Carney on BOC Guidance; Hold to 2023

By Greg Quinn

OTTAWA (MNI) - BOC Governor Tiff Macklem started his seven-year term off with a thunderclap, signaling unchanged rates through a recovery that runs into 2023 even without another Covid wave, reviving guidance discouraged by Stephen Poloz and going further than Mark Carney did in the global financial crisis.

Macklem said the key rate will remain 0.25% until inflation is sustainably at the BOC's 2% target, and projected CPI will average 1.8% in Q4 2022. He also affirmed a pledge to buy at least CAD5 billion a week of federal bonds until the recovery is well underway and said more stimulus will be deployed if needed to fight the biggest slump since the Great Depression.

"We are being unusually clear that interest rates are going to be low for a long time, and we judge that combined with the re-enforcement through quantitative easing provides an appropriate degree of monetary policy to support the recovery," he told a press conference.

When asked by MNI if QE will be scaled back well before rates rise, Macklem indicated that it's possible but that the need to make that decision won't arise until far into the future.

"Logically yes, the recovery being well under way comes before capacity has been fully absorbed, but those of those are some ways off," he said. "We will be looking for signs that the recovery is becoming more self-sustaining."

Economists surveyed by MNI were unanimous the rate would be unchanged, but few expected forward guidance to come at this meeting because economic data was still too volatile.

BOC officials also discussed the potential of yield curve control before Wednesday's decision but have not reached a conclusion on deploying the tool.

--LONG CLIMB OUT

"The timing of the first BOC hike could be similar to that for the Fed, in early 2023," CIBC chief economist Avery Shenfeld said in a research note. "The phrase 'well underway' also suggests that QE will end before the policy rate is hiked, implying that the BoC will tolerate a steeper curve as the economy and vaccine research both make progress."

Macklem said "it's going to be a long climb out" of the pandemic's disruption even with fiscal policy playing a "critical role" in boosting demand. GDP will fall 7.8% this year, and in 2022 potential output will still be 4% below what was expected before the pandemic, according to the BOC's Monetary Policy Report.

The BOC rate matches the lowest since it opened in 1935. Carney first took the rate to 0.25% in April 2009 before making a "conditional commitment" to hold that mark for a just over a year. Carney then ended the freeze a bit early as the economy picked up.

There is still little immediate risk seen from deflation, with CPI estimated at -0.1% in Q2 and +0.4% in Q3 and Q4. The economy likely hit bottom in April, the BOC said.

--HOUSING DEBT RISK

The BOC's scenario assumes no second wave of Covid-19 in Canada or abroad, though there remain downside risks to global GDP that's expected to fall 5.2% this year.

"After the initial bounce back in GDP growth, the economy is expected to enter a more protracted and gradual recovery," the BOC said. "In Canada, a much weaker scenario could crystalize the risks associated with high household indebtedness."