Bank of Canada Review: October 2020

As anticipated, the BOC left the policy rate at the "effective lower bound" of 0.25% Wednesday, policy makers reiterating the rate will remain there until slack is absorbed and inflation sustainably returns to their 2% target. Recent renewed Covid-19 restrictions, however, will hurt growth in coming months while major slack in the economy will keep inflation below 2% into 2023, the BOC said.

"The economic recovery is projected to be prolonged, underpinned by policy support but largely influenced by the evolution of the virus, ongoing uncertainty and structural changes to the economy."

Not widely anticipated, however, was the drop total weekly bond purchases as the Bank recalibrates “QE program to shift purchases towards longer-term bonds,” Governor Tiff Macklem and his deputies said in the statement.

“Given the expected impact from buying more longer-term bonds, the Governing Council judges that, as we gradually reduce our total weekly bond purchases from at least $5 billion to a minimum of $4 billion, our QE program will continue to provide at least as much stimulus as before.”

The final interest rate announcement for 2020 will be Wednesday, December 9. The first rate announcement of 2021 will be Wednesday, January 20 and include the quarterly Monetary Policy Report (MPR).

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.

Relevant Links

Policy Announcement:
Link: https://www.bankofcanada.ca/

Policy Press Conference: Tiff Macklem, Governor Bank of Canada and Senior Deputy Governor Carolyn Wilkins to discuss the contents of the Report:
https://www.bankofcanada.ca/multimedia/mpr-press-conference-webcasts-october-2020/

Sell-Side Analyst Reviews:

TD Securities

On the Banks tapering announcement from $5B to $4B in weekly bond purchases TD said "effectively the Bank is signaling that they want to keep a cap on longer-term bond yields, but do not want to tie themselves to a specific target rate. The forward guidance on QE was unchanged, pledging to continue with QE until the recovery was well underway."

The latest policy announcement "indicates a preference for a more flexible approach to QE rather than a more rigid Yield Curve Control regime" TD wrote. "If the long-end comes under further pressure in the winter, we expect the Bank will respond by shifting further to long-end purchases."

From a markets perspective, the Bank's shift to the long end " is not a catalyst to buy longs, the play here is to trade the range in the 10s30s curve. The BoC is telling the market they want to keep the long-end in check but they are not obviously telling the market to put on flatteners."

CIBC Capital Markets

Ian Pollick, CIBC's global head of fixed income, currency and commodities said the Bank "created some confusion" in announcing the tapering of weekly bond purchases and the "recalibrating the maturity of purchases to 'longer-term bonds'."

Pollick noted the choppy price action that ensued after the announcement suggested "market participants are assuming the long-end is where the purchases will be directed towards, though we vehemently disagree."

According to the MPR "the Bank describes, in detail, what they mean in regards to these maturities, specifically noting that "In particular, fixed-rate households and corporate borrowing tends to be most closely linked to 3- to 15yr GoC bond yields". From our lens, that means the calibration the Bank is discussing means purchasing more 5yrs and 10yrs, not 30yrs."

From a markets perspective Pollick said "the net impact of the lengthening of purchases is that more dv01 risk will be removed from the market. In turn, the tapering announced today should have very specific imprint on the maturities now seen as being more supported. At the limit, today reinforces the view that butterfly trades like 2s5s10s and 5s10s30s are the clearest winners once the calibration takes effect."

MNI Policy Reviews

BOC Tapers & Twists QE, Resists Negative Rates

By Greg Quinn

OTTAWA (MNI) - The Bank of Canada tapered and twisted QE Wednesday to help bring low interest rates to firms and households through a prolonged comeback from Covid-19, while Governor Tiff Macklem said the policy rate will remain 0.25% into 2023 unless a new slump brings negative interest rates into consideration.

Macklem told reporters after a policy announcement that negative rates "could be disruptive" in today's economy and the option was not discussed in the latest deliberations. "But it is in the toolkit, and if the situation were to dramatically change, it is something we could consider, that's what I meant by 'never say never,'" a comment he made earlier this month. "The bar would be very high" to move to negative rates, he said. The Bank of Canada said in 2016 around its last mandate renewal that rates could move as low as -0.5%.

The governor also said QE will be more effective even as the pace will be slowed to at least CAD4 billion of government bonds a week from at least CAD5 billion. That's because the focus will shift away from the short end where rates are already very low to longer-term purchases, he said, adding that if more QE is needed later the BOC can adjust again.

"The exit is some way off. By making our program more efficient today, we can actually buy less and provide just as much monetary stimulus, at least as much," Macklem said in response to a question from MNI about other central banks that have failed to end QE a decade after the global financial crisis.

"In a world with a lower neutral rate of interest, we can expect that central banks around the world are going to be hitting the effective lower bound more often, as we go through future cycles, and so we are going to have to think more about how to both use these programs when we need them, and unwind them when we don't need them," Macklem said.

STEADY STANCE

The majority of financial market economists and a shadow council run by the C.D. Howe Institute expected the pace of QE to remain the same today. Several said a tapering was possible because the BOC was on pace to own more than half the stock of federal bonds over the next year.

"Despite some tweaks announced today, the overall stance of monetary policy is little changed with rates set to remain low for an extended period," RBC senior economist Josh Nye wrote in a research note.

Macklem's opening statement stressed a long and difficult recovery ahead, for example saying that potential growth will be limited to 1% through 2023. "We are particularly focused on the downside risks to our projection," he said.

MNI POLICY: Canada to Restore Fiscal Anchor as Economy Firms

By Greg Quinn

Canadian Finance Minister Chrystia Freeland said Wednesday she intends to restore a fiscal "anchor" as the economy recovers, but for now she will press ahead with record deficits that save money in the long term by boosting employment and growth.

Freeland declined to say when fiscal goals that earlier included deficits in dollar terms or a share of GDP will be restored during her speech. Rock-bottom interest rates and a low debt burden before Covid-19 make the red ink affordable, and the government has a moral obligation to get people back to work, she said.

"The risks of fiscal inaction outweigh the risks of fiscal action. Doing too little is more dangerous and potentially more costly," Freeland said. She also said fiscal policy must do more with monetary policy running out of firepower, speaking hours after the BOC held a 0.25% rate and pledged continued QE.

Canada is running into the longest period since its founding in 1967 without a budget, and since an informal update in July putting the deficit at a record CAD343 billion has added tens of billions worth of programs. The IMF says Canada's deficit as a share of GDP is the highest among advanced economies, though even at around 20% it's still shy of an all-time record set during World War II.

Opposition parties that must support the Liberal government's budget to avoid a snap election have shown little objection to near-term deficits, and neither have global investors who have pushed yields to record lows. Business groups have told MNI the lack of an anchor hurts confidence and some of the spending has missed the mark on helping pay rent and wages .

MEANINGFUL INVESTMENT

With the Bank of Canada saying Wednesday the economy won't return to full output until sometime in 2023, Freeland's message suggests a big deficit next year too.

"We will need to provide meaningful investment to build our way out of the coronavirus recession, and to ensure our economy comes roaring back, stronger than before," Freeland said. "Our fiscally expansive approach to fighting the coronavirus cannot and will not be infinite."

Deflation and stagnation are a bigger risk today than the high inflation and interest rates of the 1990s that pushed Canada into a deficit crisis, she said. Canada doesn't believe in any "fling" with Modern Monetary Theory on deficits, and the fiscal rules will come before any "lash" from investors heading for the exit, she said.

"We will resume the longstanding, time tested Canadian approach with fiscal guardrails and fiscal anchors that preceded the pandemic," she said.