MNI BoC Review: March 2021

MNI View: April 21 Meeting Will Be Pivotal

As expected, the Bank of Canada held it's policy rate steady at the lower bound of 0.25% (bank rate at 0.5, deposit rate at 0.25) Wednesday, and kept asset purchases to at least CAD4 billion a week.

There were no real surprises from the Bank as they threaded the needle between economic optimism and caution as the battle against the spread of Covid-19 and more virulent strains remains continues. The Bank took the surge in global yields and steeper curves in stride amid a stronger US growth outlook while "global financial conditions remain highly accommodative."

"In Canada, the economy is proving to be more resilient than anticipated to the second wave of the virus and the associated containment measures. Although activity in hard-to-distance sectors continues to be held back, recent data point to continued recovery in the rest of the economy," BoC governing council members.

"Despite the stronger near-term outlook, there is still considerable economic slack and a great deal of uncertainty about the evolution of the virus and the path of economic growth. The labour market is a long way from recovery, with employment still well below pre-COVID levels."

While the economic outlook has improved on balance, hiking rates after reaching and sustaining 2% inflation remains a long way off with most analyst estimates around late 2022- to 2023, more-or-less in-line with the Bank's estimate.

"We remain committed to holding 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 the Bank's January projection, this does not happen until into 2023."

Relevant Links

Policy Announcement:

BOC

Progress Report on the Economy:

BoC Deputy Governor Lawrence Schembri

Bank of Canada 2021 Policy Schedule:

Wednesday, April 21

Analyst Reviews

BMO: "The Bank noted that the economy has performed significantly better than the January Monetary Policy Report projections with Q4 GDP growth nearly doubling their call and Q1 'now expected to be positive'. All aspects of domestic activity had some positive comments, with housing "much strong than expected", consumers and businesses "adapting to containment measures", and rising commodity prices and foreign demand supporting exports and business investment. With respect to the latter, the coming U.S. fiscal package and progress on the vaccine front are providing a lift."

- "As signalled by Governor Macklem's speech a few weeks ago, the labour market appears to be taking on a greater role for policymakers. That suggests a more dovish policy path until we broad-based improvement in employment."
- No inflation surprises: "inflation is likely to rise to the top of the 1-3% target band in the next few months. That's fully expected as the huge drop in prices from a year ago fall out of the calculation. Beyond the next few months, inflation looks to be more subdued, as excess capacity exerts 'downward pressure.' The January statement said inflation is expected to return to 2% in 2023 as slack is absorbed. That was omitted from this statement, likely not to send any message, but because the backdrop has changed so much, there's no need to refer to their old forecasts more than once."
- BMO noted some subtle changes in the last paragraph of the statement that the "closing of the output gap in 2023 was repeated but with the caveat that it was their January forecast. The word 'continues' was added to this sentence 'As the Governing Council continues to gain confidence in the strength of the recovery, the pace of net purchases of Government of Canada bonds will be adjusted as required.' That reinforces that the BoC believes conditions have improved, and perhaps if there are no hiccups over the coming weeks and months they could start to taper their QE program as soon as the spring."

CIBC: The BoC walked a tightrope in relaying their message without the benefit of the MPR: "Policymakers acknowledged that their forecasts from January now look too conservative in light of recent data, but didn't go much further than to say that the first quarter now looks likely to grow rather than contract."

- "The central bank continued to point to the considerable economic slack and uncertainty in maintaining its forward guidance on rates and bond purchases. Indeed, the communique fell short of pulling forward the timing of when the economy is expected to be healed enough to raise rates, with the only change an acknowledgment that the 2023 date for that timing is from the January projections."
- Eye on April announcement: CIBC points out "that's more dovish than what the market has priced in and our own forecast, which now projects the first hike to occur in late 2022, but hints that it could be pulled forward in the April Monetary Policy Report."
- "The central bank also chose to leave its quantitative easing program untouched, at least for now. The short statement seems to have taken a do no harm approach, kicking the can down the road until April to make any changes to the conditional commitment or pace of bond purchases. The central bank will have an easier time altering both by then since there will be full set of new projections to accompany the announcement. There will also be fewer assets maturing from the central bank's balance sheet, making it easier to taper gross bond purchases while still growing the overall balance sheet. Canadian fixed income yields have fallen slightly and the loonie is a bit weaker following the release."

Citi: With no major changes, Citi anticipates the BoC will announce the winding down of asset purchases at the next meeting on April 21.

- "As expected, the statement acknowledged that the winter slowdown from rising virus cases and new business closures in reality was much shallower than BoC forecasts had implied. While led by an inventory build, Q4-2020 GDP was much stronger than expected and Q1 GDP growth is very likely to be positive. The housing market was also pointed out in the statement as a source of unexpected strength. Still, the statement again acknowledged 'considerable economic slack and a great deal of uncertainty about the evolution of the virus and the path of economic activity'."

- Inflation characterization: "adjusted only slightly in the policy statement, with the BoC acknowledging upcoming base-effects and rising energy prices that will push headline CPI much higher. The statement mentioned that core measures are still in a range at or below 2%, but notably dropped the previous reference to sustainably at-target inflation only being achieved by 2023. This is an ever-so-slightly hawkish shift in our view, with our forecast for at-target inflation to be met much earlier."
- "The reference to a closing output gap in 2023 was maintained in the paragraph on policy guidance as expected, but the removal of the 2023 reference with regards to inflation could be an early signal for a similar upcoming adjustment to the date-based policy guidance."
- Citi said the BoC "will need to pull this guidance forward given a faster-than-expected rebound in activity. This shift could happen as early as the April meeting, when the MPR will also feature an updated estimate of potential GDP and thus the output gap. Of course, the two references to 2023 are closely related in that sustainably at-target inflation only occurs because the output gap has closed. We now see the possibility that the BoC could remove date-based policy guidance altogether, although this would be hawkish in our view and would not go unnoticed by market participants."

Goldman Sachs: Cautiously conservative as "liftoff remains tied to core inflation: the Bank acknowledged "that 'economic prospects have improved' while also noting that uncertainty remains elevated. The Bank maintained its expectation for inflation to temporarily spike in coming months before moderating under excess capacity."

- "The changes to the policy language were small, but slightly dovish in terms of the policy rate and slightly hawkish-to-neutral in terms of tapering. The qualifier 'sustainably' was added to the inflation liftoff criterion in the title, further emphasizing that temporarily hitting 2% inflation is insufficient to hike. The addition that policymakers 'continue' to gain confidence in the strength of the recovery in the tapering guidance, along with the characterization of global financial conditions as 'highly accommodative', supports our Q2 tapering forecast."
- Scaling bank asset purchases:, the BoC "provided a subtle hint that they are on track to taper relatively soon by adding the word "continues" in the guidance: 'As the Governing Council continues to gain confidence in the strength of the recovery, the pace of net purchases of Government of Canada bonds will be adjusted as required.' While some investors may have looked for a stronger tapering signal, we think that this addition, in combination with the description of global financial conditions as 'highly accommodative', suggests that the BoC believes it is approaching tapering.
- While liftoff will hinge on core inflation—which is difficult to forecast several years out—the emphasis on "sustainably" supports our view that the BoC's policy rate reaction function is a bit more dovish than markets appreciate. We expect the BoC to be the first G10 central bank to liftoff in 2023Q3.

ING: Little more "upbeat" than in January, the Bank said the Canadian economy is "'proving to be more resilient than anticipated to the second wave of the virus'. Consequently, the bank now expects a modest positive GDP number for 1Q rather than the contraction it had been penciling in back in January."

- "There is no talk of additional tapering (remember the BoC reduced asset purchases from C$5bn to C$4bn per week last October, but focused those remaining purchases at the longer end of the yield curve). Instead, the bank says that QE is set to continue 'until the recovery is well underway'."
- "The next meeting in April could pave the way for an additional move given that it will be accompanied by new forecasts."

JPM: "The Bank acknowledged that the economy was proving to be more resilient than anticipated to the second wave of the COVID-19 virus," but "continued to emphasize the great deal of uncertainty around the virus and the path of economic growth. The Bank could gain more confidence in the strength of the recovery on firming labor market conditions and some clear optimism expressed in the next Business Outlook Survey before the April meeting."

- JPM posited the Bank could announce the start of QE tapering in the first half of 2021, "but the Bank's emphasis on the considerable amount of economic slack and the continued uncertainty around the virus and the path of economic growth seemed to throw water on an imminent reduction in the pace of QE purchases."

- "However, economic events over the next few weeks may overtake the dovish sentiment. A firming in labor market conditions and some clearly expressed optimism in the next Business Outlook Survey could be convincing signals for the Governing Council before the next meeting. The Bank may judge that the recovery appears more reliable and more durable and an adjustment to the QE program is warranted. The data set over the next few weeks will clearly play into the Bank's decision making at the April meeting."
- JPM forecasts the Bank "is more likely to begin to adjust the pace of QE later in 2021 when the clouds really lift on the progress of the virus/vaccinations and good progress in the labor market has been confirmed. Governor Macklem has expressed concern about the very high rate of long term unemployment and the devastating and lingering effects of the pandemic on female and youth employment so we believe signs of a more inclusive recovery has become an important consideration at the Bank."

RBC: The BoC "acknowledged upside risks to its growth forecasts as the economy is "proving to be more resilient than anticipated" during the second wave. It noted Q1 growth is likely to positive rather than the contraction that was assumed in January We recently revised our 2021 GDP growth forecast to 6.3% from 4.9% previously; the BoC's projection was 4.0% in January. We see the Canadian economy returning to full capacity in 2022, sooner than the central bank has assumed. That leaves us expecting a rate hike in the second half of 2022 which markets are currently pricing in."

- RBC anticipates the BOC to announce the start of QE tapering at the April 21 policy meeting. "In January the bank indicated it would reduce the pace of asset purchases if growth was in line with expectations. It didn't sharpen that guidance today but given upside surprises in GDP growth we think an April taper (from $4 billion to $3 billion per week) is in order. The impact of that announcement on financial conditions should be modest given the BoC's guidance on tapering and the fact that reduced purchases will also coincide with reduced new issuance by the government in the upcoming fiscal year."

Scotiabank: "The Bank of Canada probably just teed up an April reduction of its bond purchase program yet the fact it chose not to do so today drove a minor dovish market response. CAD depreciated by about a quarter penny to the USD and the two-year GoC yield rallied by about two basis points. Meh. Neither of these are significant moves, but there is a strong case for arguing that markets didn't read enough into the clues provided about where they are going with this."

- "The statement struck a more optimistic overall tone. It flagged higher oil and other commodity prices, how the US recovery is gaining momentum aided by new fiscal stimulus, and sounded dismissive toward currency movements by referencing its stability against the USD as the prime cross in terms of the majority of Canada's trade relationships. These are positive signals toward forecast revisions."
- "Guidance toward the performance of the Canadian economy was also upgraded as expected. It simply would not have been credible to do otherwise after Q4 GDP grew by twice the pace the BoC had forecast. As expected, the BoC struck out reference to expectations for a Q1 contraction."

TD: The Bank also acknowledged that Q1 growth is now expected to be positive, and cited commodity prices and foreign demand as factors supporting the outlook for business investment and exports" but "also emphasized that there is still considerable slack in the economy and that uncertainty remains heightened amid the ongoing pandemic. The Bank flagged COVID variants and renewed containment measures as the largest downside risks to the recovery."

- Focus on the April meeting: "Given that markets were already positioned for tapering next month, there was no need for to the BoC to overtly signal that they were likely to make a change, and we look for the Bank to announce a reduction in weekly GoC purchases from $4bn to $3bn per week at the next week. However, the Bank's continued pledge to provide ongoing stimulus may argue for a duration-neutral reduction in purchases, similar to the October re calibration."
- "The April meeting will also be pivotal as it will include an updated MPR and allow the Bank to revise its timeline for the return to full output. To the extent that the paragraph expressing caution had a function, it would've been to prevent markets from pricing in additional hikes for 2022. The Bank had been notably

quiet on the improved growth backdrop ahead of today's policy statement but a deeper analysis of the outlook along with potential revisions to the supply-side will give the Bank the opportunity to endorse or push back on the market pulling forward rate hikes."

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