Bank of Canada Preview: Resist The Chips

The Bank of Canada is a statement-only affair at 10amET tomorrow morning followed by Deputy Governor Lynn Patterson's Economic Progress Report the day after. Relative to what is priced into OIS— which is not even a handful of basis points upward by year-end—**I would expect the BoC to either sound neutral to markets or—more likely—come across with a slightly more hawkish than priced bias.** To turn more dovish *relative to what is already priced*—would require entertaining rate cuts and that's unlikely.

In his speech on February 21st, Governor Poloz turned down the option to follow in Fed Chair Powell's footsteps after Powell entertained bidirectional rate risk by referencing a 'flexible' approach in addition to being 'patient' while 'watching' and 'waiting'. Poloz only entertained the need to rise to neutral over time with a breed of patience that is nearer-term through explicit reference to rebound expectations and in more veiled patient fashion. Codifying 'patient' tomorrow is unlikely, but would only tell the markets what they think they've already figured out through a very crowded trade with total clarity.

New information since Poloz spoke has been fairly light. The Q4 GDP disappointment was a little more than the BoC expected in the January MPR (0.4% versus 1.3%) but we don't know what number Poloz had in his head that incorporated fresher information when he spoke less than two weeks ago. Let's say he thought sub-1%; does a half point miss cause him to fully re-write the narrative? I doubt it. And on spillover effects of weak growth into Q1, the BoC was already onto that back in the January MPR with 2019Q1 annualized growth projected to be 0.8% and now facing the possibility of only relatively marginal additional downward pressure. Some of that Q4/Q1 downside might be punted into subsequent quarters with more conviction toward a rebound. In short, Poloz has been speaking of rebounds and rate hikes while anticipating a very poor 2018Q4–2019Q1 outcome. Further, since Poloz spoke, CAD has depreciated another penny and a half and the precise GDP number doesn't change the narrative that Q4/Q1 were expected to be weak as they wrote in the January statement:

> "The Bank projects real GDP will grow by 1.7 per cent in 2019, 0.4 percentage points slower than the October outlook. This revised forecast reflects a temporary slowing in the fourth quarter of 2018 and the first quarter of 2019."

I would watch for similar rebound language tomorrow. The 2019 full year outlook may be rather similar or a tick or two lower pending further information like the coming Federal Budget.

RISE. OVER TIME. AND NEUTRAL.

Key is therefore to expect the statement to repeat the following remark that was also in Poloz's recent speech:

> "…the policy interest rate will need to rise over time into a neutral range to achieve the inflation target."

Rise. Over time. And neutral. There is no reference to being flexible in a downward sense in that collection of words. The Canadian twist to the US policy shift—temporary though it may well be stateside—is more about idiosyncratic shocks that depress Q4/Q1 growth before an expected rebound; if that rebound doesn't happen, then we'll see, but don't throw out the beaker before the experiment is over.

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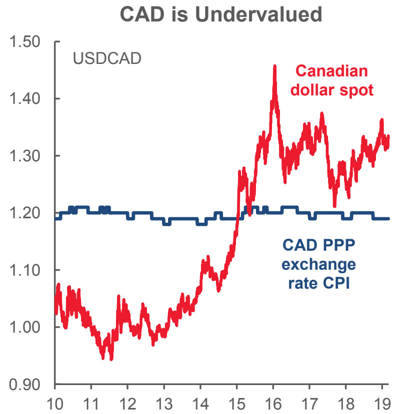
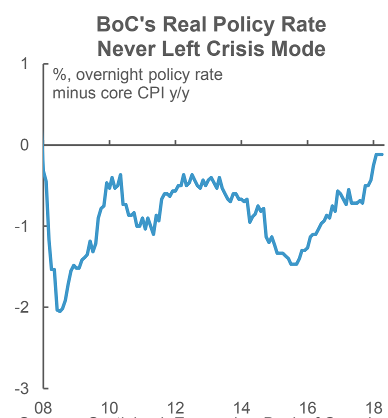
Chart 1



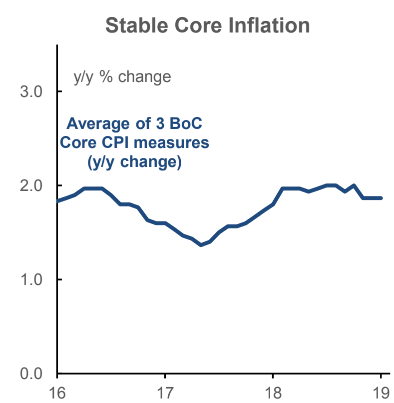
Sources: Scotiabank Economics, Bloomberg.

Chart 2



Sources: Scotiabank Economics, Bank of Canada, Statistics Canada.

Chart 3



Sources: Scotiabank Economics, Statistics Canada.

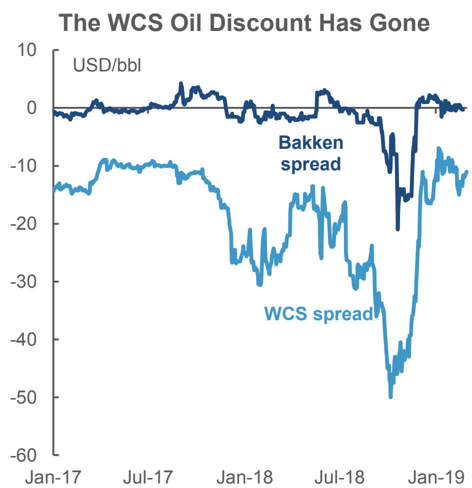
Indeed the luxury of speaking to rate hikes in future is partly afforded by a very different currency than the Fed faces with broad US dollar strength versus CAD weakness (chart 1). Signal a more dovish than priced view toward a possible cut or even just ambiguity toward the directional risks, and the BoC is risking USDCAD testing 1.40 since markets get that you can't just dip your hand in the bag of chips once (well, I can't anyway). USDCAD 1.40ish combined with an expected rebound in the economy is a renewed inflation problem given high import propensities with the currency several dimes depreciated compared to when oil prices collapsed and the BoC cut back in 2014–15.

A lower starting point for the currency at a still negative real policy rate compared to the Fed's slightly positive rate plus the BoC's strict focus upon conventional rate policy with no balance sheet issues to unwind and a tanked currency connote a different, still laxer monetary policy environment north of the border. This is still, after all, a central bank that has yet to leave crisis mode (chart 2) despite essentially having sustainably achieved its inflation mandate (chart 3).

Signal openness to a cut and you're prejudging the March 19th budget by assuming that Minister Morneau fiddles while the incumbent government's polls burn. A cut or two plus a plunging CAD + fiscal stimulus + an economic rebound = a possibly unpleasant retirement party on June 3rd 2020 and a cynical 'thanks a lot' from his successor. Signal a more dovish than priced bias and financial stability risks overhanging household balance sheets get fanned just when Ottawa likely adds to housing stimulus in the Budget; haven't we seen this movie before and know how it ends?

Overall, expect a briefly worded statement with few comparators to the last one in January that was a forecast oriented MPR statement. Much of the transitory shock reference will rest upon the very different shock to oil prices this time around that have already rebounded from last Fall's brief plunge (chart 4). The BoC will issue full forecasts at the April 24th meeting with the next MPR and that will be the more important occasion when they could revise actual and potential GDP forecasts and neutral rate assumptions. In the meantime, now is about buying time. With no one expecting much from Q1 as Alberta's mandated cuts bite and with a rebound yet to be tested, time is on the BoC's side to do a proper dissection of the balance of risks to the outlook. Overall, the arguments provided in the Canadian section of the Global Week Ahead sent last Friday still hold (here), with a few additions in this short note.

Chart 4



Sources: Scotiabank Economics, Bloomberg.