BoC Turns More Dovish, But Markets Are Prematurely Toying With Cut Risk

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- **In a fairly short statement, the Bank of Canada abruptly took a more dovish than expected turn that has the market thinking of the modest prospect of a rate cut by the end of this year. That may well be premature as explained in a moment.** CAD depreciated by about half a penny after the release and the two year yield dropped by about 5bps—and counting—to add to the pre-announcement rally that has the yield down 7bps on the day. Kudos to those who positioned for it or called it on a job well done as we did not. Mortgage borrowers are rejoicing as the GoC 5 year yield drops 5bps and 8bps on the day and 13bps since the end of February. I think it's an over-reaction by the BoC that risks another about face much later on the view that better days are ahead, but the message points toward no rate hike for the bulk of the year at a minimum. It will take until at least well into H2 and probably late year before we're chancing a return to debating the timing of a possible BoC hike. That probably pushes hike risk until after the Federal election.

- **Key is that the statement struck out prior references to how "Governing Council continues to judge that the policy interest rate will need to rise over time into a neutral range to achieve the inflation target."** Governor Poloz repeated this guidance as recently as his speech and press conference on February 21st. The Q4 GDP disappointment is among the driving factors being cited for this change along with a re-take on global considerations. Easier financial conditions since then apparently weren't enough to assuage BoC concerns toward the risks. Instead, the BoC replaced this guidance with reference to how **"Governing Council judges that the outlook continues to warrant a policy interest rate that is below its neutral range."**

- We'll have to wait until the April MPR—with the off chance of Patterson's speech tomorrow—for fresher guidance from the BoC on where they think the neutral rate is but our house assumption is that it sits at about 2½% and hence at the low end of the BoC's range and compared to the present 1.75% level of the overnight rate.

- **One can at least say that Poloz did not go down Fed Chair Powell's path by embracing ambiguity toward the direction of the next rate move, or at least not yet.** Unlike the Fed, there is no 'flexible' language on the direction of future rate moves, and no guidance toward the next move possibly being either up or down; that guidance is still up but likely not for quite some time. This statement is just a Canadian version of the Fed's 'patient', 'watching' and 'waiting' minus 'flexible'. **The BoC still guides toward "future rate increases" in the statement**, but says that there is higher uncertainty about the path now. Indeed, reference to "it will take time to gauge the persistence of below-potential growth and the implications for the future inflation outlook" cements a prolonged pause.

- **If the BoC hikes this year, then the best case scenario is toward year-end if all goes smashingly well with respect to rebound expectations.** The note of such optimism is derived from reference to how "global economic prospects would be buoyed by the resolution of trade conflicts" which squarely points the finger at the Trump administration. Trade deals from US-China to averting auto tariffs against Europe and possibly others and ratifying CUSMA/USMCA could well spark a future pivot.

- The downward revision to the inflation projection now expects it to be "slightly below the 2 per cent target through most of 2019." **That's not necessarily a re-write of the January guidance that inflation was expected to return to 2% by year-end.**

- Please see the attached statement comparison.

RELEASE DATE: MARCH 6, 2019

The Bank of Canada today maintained its target for the overnight rate at 1 ¾ per cent. The Bank Rate is correspondingly 2 per cent and the deposit rate is 1 ½ per cent.

Recent data suggest that the slowdown in the global economy has been more pronounced and widespread than the Bank had forecast in its January *Monetary Policy Report* (MPR). While the sources of moderation appear to be multiple, trade tensions and uncertainty are weighing heavily on confidence and economic activity. It is difficult to disentangle these confidence effects from other adverse factors, but **it is clear that global economic prospects would be buoyed by the resolution of trade conflicts**.

Many central banks have acknowledged the building headwinds to growth, and financial conditions have eased as a result. Meanwhile, progress in US-China trade talks and policy stimulus in China have improved market sentiment and contributed to firmer commodity prices.

For Canada, the Bank was projecting a temporary slowdown in late 2018 and early 2019, mainly because of last year's drop in oil prices. The Bank had forecast weak exports and investment in the energy sector and a decline in household spending in oil-producing provinces. However, the **slowdown in the fourth quarter was sharper and more broadly based.** Consumer spending and the housing market were soft, despite strong growth in employment and labour income. Both exports and business investment also fell short of expectations. After growing at a pace of 1.8 per cent in 2018, it now appears that the economy will be weaker in the first half of 2019 than the Bank projected in January.

Core inflation measures remain close to 2 per cent. CPI inflation eased to 1.4 per cent in January, largely because of lower gasoline prices. The Bank expects CPI inflation to be slightly below the 2 per cent target through most of 2019, reflecting the impact of temporary factors, including the drag from lower energy prices and a wider output gap.

Governing Council judges that the outlook continues to warrant a policy interest rate that is below its neutral range. Given the mixed picture that the data present, **it will take time to gauge the persistence of below-potential growth and the implications for the inflation outlook. With increased uncertainty about the timing of future rate increases, Governing Council will be watching closely developments in household spending, oil markets, and global trade policy.**

RELEASE DATE: JANUARY 9, 2019

The Bank of Canada today maintained its target for the overnight rate at 1 ¾ per cent. The Bank Rate is correspondingly 2 per cent and the deposit rate is 1 ½ per cent.

The global economic expansion continues to moderate, with growth forecast to slow to 3.4 per cent in 2019 from 3.7 per cent in 2018. In particular, growth in the United States remains solid but is expected to slow to a more sustainable pace through 2019. However, there are increasing signs that the US-China trade conflict is weighing on global demand and commodity prices.

Global benchmark prices for oil have been about 25 per cent lower than assumed in the October *Monetary Policy Report* (MPR). The lower prices primarily reflect sustained increases in US oil supply and, more recently, increased worries about global demand. These worries among market participants have also been reflected in bond and equity markets.

The drop in global oil prices has a material impact on the Canadian outlook, resulting in lower terms of trade and national income. As well, transportation constraints and rising production have combined to push up oil inventories in the west and exert even more downward pressure on Canadian benchmark prices. While price differentials have narrowed in recent weeks following announced mandatory production cuts in Alberta, investment in Canada's oil sector is projected to weaken further.

These developments are occurring in the context of a Canadian economy that has been performing well overall. Growth has been running close to potential, employment growth has been strong and unemployment is at a 40-year low. Looking ahead, exports and non-energy investment are projected to grow solidly, supported by foreign demand, the CUSMA, the lower Canadian dollar, and federal tax measures targeted at investment.

Meanwhile, consumption spending and housing investment have been weaker than expected as housing markets adjust to municipal and provincial measures, changes to mortgage guidelines, and higher interest rates. Household spending will be dampened further by slow growth in oil-producing provinces. The Bank will continue to monitor these adjustments.

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. This will open up a modest amount of excess capacity, primarily in oil-producing regions. Nevertheless, indicators of demand should start to show renewed momentum in early 2019, leading to above-potential growth of 2.1 per cent in 2020.

Core inflation measures remain clustered close to 2 per cent. As expected, CPI inflation eased to 1.7% in November, due to lower gasoline prices. CPI inflation is projected to edge further down and be below 2 per cent through much of 2019, owing mainly to lower gasoline prices. On the other hand, the lower level of the Canadian dollar will exert some upward pressure on inflation. As these transitory effects unwind and excess capacity is absorbed, inflation will return to around the 2 per cent target by late 2019.

Weighing all of these factors, **Governing Council continues to judge that the policy interest rate will need to rise over time into a neutral range to achieve the inflation target.** The appropriate pace of rate increases will depend on how the outlook evolves, with a particular focus on developments in oil markets, the Canadian housing market, and global trade policy.

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