BoC Is On A Siesta, Leans Against Rate Cut Pricing

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- The good news to some here is that their cost of borrowing won't be going up any time soon and today's overnight rate remained at 1.75% as universally expected. The bad news is that to get to that point required the BoC to turn pretty negative toward the state of the Canadian economy with very little growth stretching from 2018Q4 to 20192 in a weak overall 2019. This is despite the BoC's best efforts to make it sound like they were being positive.
- What is now set in motion is a vigorous period of tracking data and global policy developments to assess upside or downside risks to pretty conservative forecasts. Our house assumptions and forecasts for key developments expect conditions to be somewhat more favourable than the BoC presently anticipates. **Regardless, almost as much guidance was provided against a rate hike any time soon as against a rate cut at any point such that the firm message is neutral and hence more hawkish than markets are pricing. Markets heard 'no hike' and ignored the 'no cut' message** in driving CAD down half a cent to the USD and the Canada two year yield just over 2bps lower after both markets reined in initially greater responses. OIS markets continue to price a decent chance of a rate cut before the end of the year.
- One key is that **the statement struck out reference to "future rate increases."** Specifically, they say "We will continue to evaluate the appropriate degree of monetary policy accommodation as new data arrive" before going on to repeat they are monitoring the same things: household spending, oil markets and global trade policy. **Some may read this as saying rate hikes are permanently gone. That's a bold claim versus what I think is the more suitable interpretation that leans to pausing the hike cycle for now and seeing how things go relative to the BoC's forecasts.**
- **Another key is that Governor Poloz generally poured cold water on talk of easing unless a major negative shock were to surface.** Indeed, not only is the broad forecast framework not as dovish as short-term rates markets are pricing, it's also possible that the BoC could be pleasantly surprised by developments relative to its forecasts that look rather conservative. Nevertheless, it will take some time to evaluate this risk to their forecasts such that barring a major positive or negative shock the BoC is on hold for some time and at least until late year. To assume that the BoC will never return to hiking assumes the pessimism reflected in their numbers will be borne out by reality while ignoring what may well be upside risk.
- **How did Governor Poloz specifically rebuff talk of a potential rate cut?** He did so in the press conference (at least the parts I could hear given their poor audio feed!). This made the overall suite of communications relatively more hawkish than markets are presently pricing. Poloz specifically said that if their forecast is right "which I firmly believe it to be, **then interest rates are more likely to go up than down over time**." He also said **he expects the bond market will see yields edging higher**. Poloz said he is skeptical of the most negative data received and specifically flagged weather effects (more on this in a moment). He said this is a detour with the economy still having pockets of issues that are adjusting but that the detour is confined to around two quarters in Q4 and Q1 so "in theory we're into the positive frame already". Poloz said it would take a sizeable negative shock to entertain easing. Perhaps markets are more conditioned to getting negative policy

surprises than positive ones thanks in part to political turmoil in Washington and London, but readers should constantly remind themselves that there remain two tailed risks to such developments especially into a US Presidential election year.

- Nevertheless, Poloz noted **there is no rush to "get back in the saddle" with rate hikes**. Overall, his language connotes a pause while data is evaluated which may make, say, the next 2–4 meetings rather dull affairs.
- **The BoC went pretty bearish on GDP growth.** It revised down its Q1 GDP growth tracking to 0.3% (Scotia's 'nowcast' is 1.4%) and also sees Q2 GDP growth at 1.3% with no revision because it wasn't previously published. Overall, 2019 growth was revised down by 0.5% to 1.2% (Scotia 1.6%) and 2020 was left unchanged at 2.1% with 2021 at 2.0%. Each of 2020 and 2021 are above potential and 2019 is below potential growth. The BoC notes that one-third of the half point downward revision to 2019 GDP growth was due to the hand-off from the end of 2018 while the rest is due to downgrading 2019H1. The BoC does not publish quarterly SAAR GDP growth beyond Q1 and Q2.
- **On the *level* of potential GDP, the BoC estimates it to be about 0.2% lower than estimated in January which implies less slack.** The BoC left this year's potential GDP growth rate unchanged at 1.8% but narrowed the range to 1.5–2.1%. Potential growth was revised down a tick to 1.7% and the interval was tightened by lowering the top end to 2.1% and keeping the bottom end of its range at 1.3%. In 2021, the BoC sees potential between 1.2–2.4% which is too wide and far out in the forecast horizon to matter much.
- **The combined effects result in a wider output gap with the expectation it will "be absorbed over the projection period."** It is the downward revision to actual GDP levels and growth that drives the output gap widening. Specifically, the BoC estimates the output gap to now be between -1.25% and -0.25% as at the end of Q1 after being -0.75% to +0.25% in 2018Q4. That's a material half-point widening in the output gap to enter 2019.
- **The BoC raised its CPI forecast to 1.9% this year (1.7% prior) and kept it at 2% next year with 2021 also forecast at 2.0%.** The quarterly profile on a Q4/Q4 basis was revised up a tick for 2019 and kept unchanged at 2.0% in 2020 and 2021 extended this 2.0% forecast. The BoC flags carbon pricing for a 0.1% addition to CPI this year that gets halved in 2020 and beyond by taking account of the direct effects of carbon pricing on affected items like gasoline prices while not considering indirect effects it judges to be small. Key on this 0.1% is the assumption that measures like gasoline prices are going up because of carbon taxes. When I plot average daily gasoline prices in the US compared to average prices in Canada, the two have moved higher in lock-step fashion this month and moved in synchronous fashion for some time. It's an integrated market that shouldn't have the locals just thinking about the price at their neighbourhood pump as both Americans and Canadians are paying almost identically greater amounts for gasoline of late.
- **The BoC revised lower its neutral rate range to 2.25%–3.25% with a mid-point of 2.75%, all down by 25bps**. That's not especially shocking and puts the BoC on top of the Fed's estimate, except of course it's not copying the Fed… It still conveys an impression that the BoC views stimulus to be material given a full percentage point spread between neutral and the present overnight rate of 1.75%.
- **International growth projections were slightly lowered.** The BoC now sees the world economy growing by 3.2% this year (3.4% prior), 3.3% next year (3.4% prior) and 3.3% in 2021. The US economy is projected to grow by 2.3% this year (2.4% prior) and 1.7% next (1.6% prior). China's growth was unchanged at 6.2% this year and revised up a tick to 5.9% next year.
- **There were two points in Poloz's prepared opening remarks to the press conference (here) where he noted that severe weather may have affected trade and household sector variables** but "we have taken them at face value in updating our forecast, leaving room for further growth in future months." **They would therefore get positively surprised if severe weather effects resulted in pent-up activity being released.**
- The BoC's laid out assumptions for oil prices and CAD are in keeping with standard public BoC practice to assume present levels will prevail over the forecast horizon.
- It initially read as unusual that the BoC fingered the Ontario government's belt tightening in the statement. The more prudent approach given the politics in a Federal election year may have been to say that the combined effects of the Federal and provincial fiscal policy changes since the last forecast update is judged to be a little less favourable to the BoC's 2020 forecasts. Presumably the BoC is aware of the Federal-Ontario political schism.
- Please see the attached statement comparison. Being a comparison of an MPR statement to a non-MPR statement, the highlighted comparisons are light, but key differences are highlighted.
- The full Monetary Policy Report is available here.

RELEASE DATE: APRIL 24, 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.

Global economic growth has slowed by more than the Bank forecast in its January *Monetary Policy Report* (MPR). Ongoing uncertainty related to trade conflicts has undermined business sentiment and activity, contributing to a synchronous slowdown across many countries. In response, many central banks have signalled a slower pace of monetary policy normalization. Financial conditions and market sentiment have improved as a result, pushing up prices for oil and other commodities.

Global economic activity is expected to pick up during 2019 and average 3 ¼ per cent over the projection period, supported by accommodative financial conditions and as a number of temporary factors weighing on growth fade. This is roughly in line with the global economy's potential and a modest downgrade to the Bank's January projection.

In Canada, growth during the first half of 2019 is now expected to be slower than was anticipated in January. Last year's oil price decline and ongoing transportation constraints have curbed investment and exports in the energy sector. Investment and exports outside the energy sector, meanwhile, have been negatively affected by trade policy uncertainty and the global slowdown. Weaker-than-anticipated housing and consumption also contributed to slower growth.

The Bank expects growth to pick up, starting in the second quarter of this year. Housing activity is expected to stabilize given continued population gains, the fading effects of past housing policy changes, and improved global financial conditions. Consumption will be underpinned by strong growth in employment income. Outside of the oil and gas sector, investment will be supported by high rates of capacity utilization and exports will expand with strengthening global demand. Meanwhile, the contribution to growth from government spending has been revised down in light of Ontario's new budget.

Overall, the Bank projects real GDP growth of 1.2 per cent in 2019 and around 2 per cent in 2020 and 2021. **This forecast implies a modest widening of the output gap, which will be absorbed over the projection period.**

CPI and measures of core inflation are all close to 2 per cent. CPI inflation will likely dip in the third quarter, largely because of the dynamics of gasoline prices, before returning to about 2 per cent by year end. Taking into account the effects of the new carbon pollution charge, as well as modest excess capacity, the **Bank expects inflation to remain around 2 per cent through 2020 and 2021.**

Given all of these developments, Governing Council judges that an accommodative policy interest rate continues to be warranted. **We will continue to evaluate the appropriate degree of monetary policy accommodation as new data arrive**. In particular, we are monitoring developments in household spending, oil markets, and global trade policy to gauge the extent to which the factors weighing on growth and the inflation outlook are dissipating.

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.