

Shock and Awe—The Canadian Way

- In a lesson to the rest of the world...
- ...Canada coordinated monetary, fiscal and regulatory stimulus
- The BoC cut 50bps with a dovish bias...
- ...as we expect another 50bps cut at the next meeting or sooner...
- ...and took aggressive steps to improve market liquidity
- OSFI cut bank capital requirements to free up lending
- The Federal government injected funds into its business and export lenders
- Minister Morneau guided that further fiscal steps will be announced next week

Ottawa unexpectedly came out with a three-pronged assault on the combined COVID-19 and OPEC+ shocks. It's not the direction that was unexpected so much as the sudden and coordinated timing. Three policymakers did so in a wonderfully coordinated way that showcases to the world how central banks, governments and regulators can act in unison toward a common cause versus the more splintered approaches being taken elsewhere. It may also have been motivated by expectations for aggressive action by the Federal Reserve next week and a desire to get in front of it. The outcome to what is described below provides meaningful and well-timed stimulus. We expect more to come in the form of additional guidance on fiscal policy next week and a further ½ point reduction in the BoC's overnight rate at the April 15th meeting—if not sooner.

USDCAD was initially unimpressed and largely shook off the development perhaps as it informed the view that other central banks like the Federal Reserve were rushing toward provided major stimulus which came out in the wash on the exchange rate. See [this](#) note for expectations ahead of next week's Fed meeting. The C\$ subsequently appreciated to the USD when President Trump declared the COVID-19 virus to present a national emergency.

Because bond markets were already largely priced for the BoC to return toward the lower bound at some point over the fairly near term, the Canada two year yield initially fell by about 12bps but clawed back all that and slightly more as the initial undershoot was unwound and when it became clearer that the US is moving toward stimulus efforts. The very front-end rallied across shorter maturities because of the sooner than expected development.

Here are the broad outlines of the monetary, regulatory and fiscal policy actions.

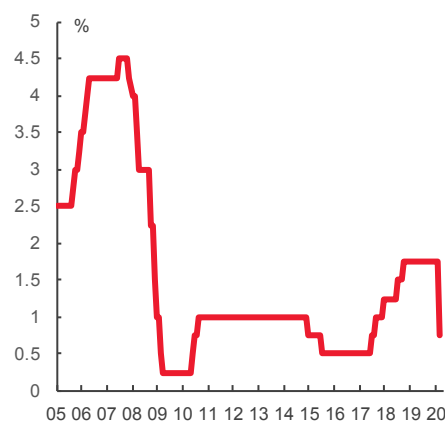
BoC RATE CUT

First, the Bank of Canada unexpectedly cut its overnight policy rate by 50bps to 0.75% in an intermeeting move after having cut by 50bps on March 4th. Only the sudden timing was unexpected as we had anticipated two 50bps reductions in a march back down to a policy rate of 0.25% and after having anticipated the March 4th 50bps reduction. Two down, one more to go.

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Bank of Canada Overnight Rate



Sources: Scotiabank Economics, Bank of Canada.

We think a further 50bps reduction is likely at the next meeting if not sooner.

DOVISH BoC GUIDANCE

A short accompanying statement [here](#) left **the door wide open to doing more**. It did so with guidance that it “stands ready to adjust monetary policy further if required to support economic growth and keep inflation on target.”

Governor Poloz held a joint press conference with Finance Minister Morneau and issued [this](#) opening statement. The statement emphasized how the impact of the COVID-19 and OPEC+ shocks to the Canadian economy had worsened since the March 4th statement which merited the intermeeting move. The statement reinforced that **the BoC ‘stands ready to do what is required to support economic growth and keep inflation on target, and we will continue to ensure that the Canadian financial system has sufficient liquidity.’**

Note, however, that Poloz also downplayed the prospect of negative rates by stating that “we can put on the shelf” the idea given other policy flexibility the BoC retains.

BoC LIQUIDITY INJECTIONS

The BoC also injected significant liquidity into the financial system through a new facility, alterations to prior initiatives and expanded repo operations.

The BoC has set up a **new Bankers’ Acceptance Purchase Facility** that is designed to provide liquidity for small- and medium-sized businesses. A statement accompanying this decision can be found [here](#). Commencing two Mondays from now, the BoC will purchase one-month BAs issued by any Canadian bank with a minimum short-term credit rating of R=1 (low) in the secondary market. The purchase size and other parameters will be revealed when the first operation is announced.

The BoC is also expanding other liquidity measures as explained [here](#). It **has expanded the Government of Canada bond buyback program** by extending it across all benchmark maturity sectors “at least weekly.” The initial operation is to be a C\$500 million 30 year switch operation this Monday with further details to follow. The BoC also announced **the addition of new six and twelve month term repo operations on a bi-weekly basis** starting this coming Tuesday. The statement provided details on the first operation. The regular one month and three month term repo operations will continue but the BoC has advised that market conditions will dictate the size, frequency and term.

Poloz also noted that **the BoC could accept some elements of the banks’ mortgage books as collateral for its stimulus efforts** which, given the size of the book today, offers more room for stimulus than in 2008.

LOWERED BANK CAPITAL REQUIREMENTS

The nation’s federal regulator—the Office of the Superintendent—complemented the BoC measures by **reducing the Bank Stability Buffer by 125bps to 1.0% as a share of risk-weighted assets**. Recall that the buffer was to have been raised to 2.25% from 2.0% effective April 30th, 2020 in order to raise safeguards on the banking system, but dropping to 1.0% is designed to stimulate lending activity in the current environment.

FISCAL STIMULUS

The third leg of the stimulus package included guidance from Finance Minister Morneau. **Morneau announced that C\$10 billion in funding will be provided to the Business Development Bank of Canada and Export Development Canada (EDC) to facilitate lending activities and trade financing.**

Morneau did his best Mario Draghi impression by stating the **Federal Government stands ready to do “whatever it takes” in order to support the economy**. Further guidance will be provided next week and the Budget—slated for release March 30th—may be released earlier. Among the options Morneau indicated that were under consideration is how to provide direct support to households.

During the press conference, it was noted that the sum total of all of these measures including prior and just announced liquidity injections, lowering the capital buffer and injecting funds into the EDC and BDC comes to about C\$300 billion. There is no supporting documentation to back this estimate.

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