GLOBAL ECONOMICS
| SCOTIA FLASH

June 3, 2020

BoC Handover Offers No Surprises

- **BoC leaves rates unchanged with no forward guidance**
- **Scaled back short term BA and repo operations are no surprise**
- **The BoC's forecast hit to Q2 GDP is lower…**
- **...but can hardly be called optimistic…**
- **…and we can't evaluate its overall forecast bias…**
- **...without updated guidance on recovery numbers**
- **Incoming Governor Macklem endorsed the statement**
- **BoC's balance sheet forecast at 40% of NGDP in one year**

CONTACTS

Derek Holt, VP & Head of Capital Markets Economics
416.863.7707
Scotiabank Economics
derek.holt@scotiabank.com

There were no material surprises in today's statement as the BoC shifts toward evaluating incoming data and prospects for a rebound. The market reaction was muted. Canada 2s cheapened in sympathy with the global move toward higher short-term yields this morning and ditto for longer term yields as global bond markets abruptly sell off in 2s10s bear steepener fashion. The Canadian dollar appreciated to the US dollar somewhat, but this is due to broad US$ depreciation and CAD is actually underperforming most other major crosses this morning.

The policy rate was left at 0.25% and Scotia Economics forecasts it to remain there throughout our 2020–21 projection horizon. There was no forward rate guidance provided in the statement which is consistent with Governor Poloz's opposition to providing such guidance (most of the time…).

Nothing else here should surprise anyone with a finger on the pulse of the markets and the economy and among regular BoC watchers. The main elements of the statement included the following with colour provided where appropriate:

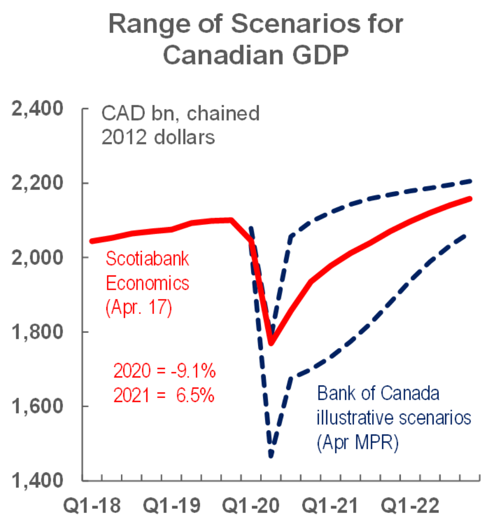
a. **Improved conditions led the BoC to reduce the term repo operations to once per week and the BA operations to shift to bi-weekly frequency.** This is not unexpected given improved funding conditions. The BoC has previously issued guidance that it sees a lessened need for such supports through short-term funding and liquidity operations including in comments delivered by Deputy Governor Lane. The BoC also took the step of dropping LVTS members' BAs and bearer deposit notes as eligible security to the term repo operations. More is available here in a separate accompanying statement.

b. **The BoC says that the Canadian economy has "avoided the most severe scenario" that was presented in April and they lowered their range of Q2 GDP hits.** This is not new information to markets as it just elaborates upon prior guidance from Governor Poloz that their base case is tracking well relative to the vaguely outlined worst case hit (see chart 1 for a reminder of the two relative to Scotia's GDP profile pending a relatively small forecast update).

c. The BoC observes that **the COVID-19 shock "appears to have peaked."** This is consistent with our belief and general market attitudes.

d. **'Uncertainty about how the recovery will unfold remains high.'** Gosh, ya think?

Chart 1



Sources: Scotiabank Economics, Bank of Canada.

e. Also not surprising is reference to how global policy responses are working to replace lost income and repair financial conditions.

f. **Inflation guidance was largely a descriptive account of what we all saw in the April numbers and carried no forward-looking meaning.** Again, no surprises folks. What we need are some numbers that will have to wait until the BoC issues more detailed forecasts next month.

g. They repeat that the 'global recovery likely will be protracted and uneven' as a partial reflection of the unevenness in which the COVID-19 shock and the OPEC+ turmoil hit different economies.

The concluding paragraph emphasized how the BoC's "focus will shift to supporting the resumption in output and employment." That makes it clearer that **this central bank is not pursuing additional programs or scaling existing ones at this point, while leaving the door open to adjust later as needed.** Again, no surprises.

Forecast guidance was slightly updated but communication was imperfect on two counts. The BoC now says that Q2 GDP is expected to decline by 10–20% at a non-annualized pace compared to April when they said 15–30%. In April they explicitly noted that Q2 was relative to Q4 GDP but this time they leave us somewhat guessing today at whether 10–20% is in relation to Q4 or Q1.

Assuming they mean -10–20% q/q relative to Q1 given that we have an actual estimate subject to revision for Q1 now, **our own guesstimate at Q2 GDP is toward the lower end of the BoC's forecast hit.** We figure Q2 will contract by around 11% q/q non-annualized. The overall H1 annualized decline in GDP compared to Q4 is forecast by the BoC to be between -22% and -39% at an annualized rate whereas we estimate -28–29%. I wouldn't call tightening-in the BoC's estimated range for Q2 GDP optimistic.

The second aspect of imperfect communication is that they don't offer updated guidance toward the speed of recovery. **By lowering the range of hits to Q2 are they leaving prior Q3-onward base case guidance unchanged or does a milder Q2 hit connote a milder recovery?** The BoC had previously guided that its base case expected lost GDP to be fully recouped by year-end (chart 1). We can't evaluate what they now believe.

Governor Poloz has now passed the baton to **Governor Macklem who was an observer during this policy round and "endorses the rate decision and measures" announced today.**

As a reminder, a detailed explanation of the forecast Bank of Canada balance sheet is available in last evening's Closing Points ([here]) and in last Friday's Global Week Ahead [here]. Charts 2 and 3 are repeated here. **A year from now, the BoC's balance sheet will likely be equal to about 40% of nominal GDP.**

Please see the appendix for the June and April statements. No tracking of changes is offered because today's statement is a full re-write in light of changed conditions and because the long April statement was associated with an MPR release.

Chart 2

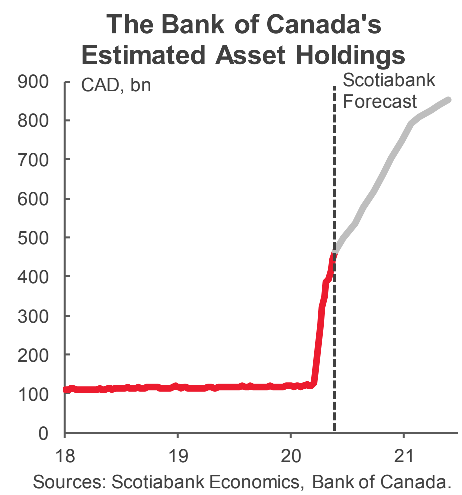
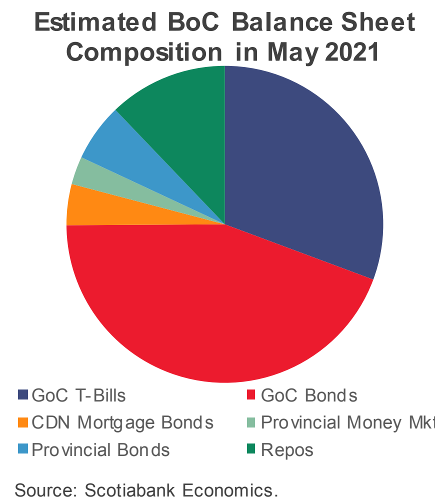


Chart 3



RELEASE DATE: June 3, 2020

The Bank of Canada today maintained its target for the overnight rate at the effective lower bound of ¼ percent. The Bank Rate is correspondingly ½ percent and the deposit rate is ¼ percent.

Incoming data confirm the severe impact of the COVID-19 pandemic on the global economy. This impact appears to have peaked, although uncertainty about how the recovery will unfold remains high. Massive policy responses in advanced economies have helped to replace lost income and cushion the effect of economic shutdowns. Financial conditions have improved, and commodity prices have risen in recent weeks after falling sharply earlier this year. Because different countries' containment measures will be lifted at different times, the global recovery likely will be protracted and uneven.

In Canada, the pandemic has led to historic losses in output and jobs. Still, the Canadian economy appears to have avoided the most severe scenario presented in the Bank's April *Monetary Policy Report* (MPR). The level of real GDP in the first quarter was 2.1 percent lower than in the fourth quarter of 2019. This GDP reading is in the middle of the Bank's April monitoring range and reflects the combined impact of falling oil prices and widespread shutdowns. The level of real GDP in the second quarter will likely show a further decline of 10-20 percent, as continued shutdowns and sharply lower investment in the energy sector take a further toll on output. Decisive and targeted fiscal actions, combined with lower interest rates, are buffering the impact of the shutdown on disposable income and helping to lay the foundation for economic recovery. While the outlook for the second half of 2020 and beyond remains heavily clouded, the Bank expects the economy to resume growth in the third quarter.

CPI inflation has decreased to near zero, as anticipated in the April MPR, mainly due to lower prices for gasoline. The Bank expects temporary factors to keep CPI inflation below the target band in the near term. The Bank's core measures of inflation have drifted down, although by much less than the CPI, and are now between 1.6 and 2 percent.

The Bank's programs to improve market function are having their intended effect. After significant strains in March, short-term funding conditions have improved. Therefore, the Bank is reducing the frequency of its term repo operations to once per week, and its program to purchase bankers' acceptances to bi-weekly operations. The Bank stands ready to adjust these programs if market conditions warrant. Meanwhile, its other programs to purchase federal, provincial, and corporate debt are continuing at their present frequency and scope.

As market function improves and containment restrictions ease, the Bank's focus will shift to supporting the resumption of growth in output and employment. The Bank maintains its commitment to continue large-scale asset purchases until the economic recovery is well underway. Any further policy actions would be calibrated to provide the necessary degree of monetary policy accommodation required to achieve the inflation target.

RELEASE DATE: April 15, 2020

The Bank of Canada today maintained its target for the overnight rate at ¼ percent, which the Bank considers its effective lower bound. The Bank Rate is correspondingly ½ percent and the deposit rate is ¼ percent. The Bank also announced new measures to provide additional support to Canada's financial system.

The necessary efforts to contain the COVID-19 pandemic have caused a sudden and deep contraction in economic activity and employment worldwide. In financial markets, this has driven a flight to safety and a sharp repricing of a wide range of assets. It has also pushed down prices for commodities, especially oil. In this environment, the Canadian dollar has depreciated since January, although by less than many other currencies. The sudden halt in global activity will be followed by regional recoveries at different times, depending on the duration and severity of the outbreak in each region. This means that the global economic recovery, when it comes, could be protracted and uneven.

The Canadian economy was in a solid position ahead of the COVID-19 outbreak, but has since been hit by widespread shutdowns and lower oil prices. One early measure of the extent of the damage was an unprecedented drop in employment in March, with more than one million jobs lost across Canada. Many more workers reported shorter hours, and by early April some six million Canadians had applied for the Canada Emergency Response Benefit.

The outlook is too uncertain at this point to provide a complete forecast. However, Bank analysis of alternative scenarios suggests the level of real activity was down 1-3 percent in the first quarter of 2020, and will be 15-30 percent lower in the second quarter than in fourth-quarter 2019. CPI inflation is expected to be close to 0 percent in the second quarter of 2020. This is primarily due to the transitory effects of lower gasoline prices.

The pandemic-driven contraction has prompted decisive policy action to support individuals and businesses and to lay the foundation for economic recovery once containment measures start to ease. Fiscal programs, designed to expand according to the magnitude of the shock, will help individuals and businesses weather this shutdown phase of the pandemic, and support incomes and confidence leading into the recovery. These programs have been complemented by actions taken by other federal agencies and provincial governments.

For its part, the Bank of Canada has taken measures to improve market function so that monetary policy actions have their intended effect on the economy. This helps ensure that households and businesses continue to have access to the credit they need to bridge this difficult time, and that lower interest rates find their way to ultimate borrowers. The Bank has lowered its target for the overnight rate 150 basis points over the last three weeks, to its effective lower bound. It has also conducted lending operations to financial institutions and asset purchases in core funding markets amounting to around $200 billion.

These actions have served to ease market dysfunction and help keep credit channels open, although they remain strained. The next challenge for markets will be managing increased demand for near-term financing by federal and provincial governments, and businesses and households. The situation calls for special actions by the central bank. To this end, the Bank is furthering its efforts with several important steps.

Under its previously-announced program, the Bank will continue to purchase at least $5 billion in Government of Canada securities per week in the secondary market, and will increase the level of purchases as required to maintain proper functioning of the government bond market. Also, the Bank is temporarily increasing the amount of Treasury Bills it acquires at auctions to up to 40 percent, effective immediately.

The Bank is also announcing today the development of a new Provincial Bond Purchase Program of up to $50 billion, to supplement its Provincial Money Market Purchase Program. Further, the Bank is announcing a new Corporate Bond Purchase Program, in which the Bank will acquire up to a total of $10 billion in investment grade corporate bonds in the secondary market. Both of these programs will be put in place in the coming weeks. Finally, the Bank is further enhancing its term repo facility to permit funding for up to 24 months.

These measures will work in combination to ease pressure on Canadian borrowers. As containment restrictions are eased and economic activity resumes, fiscal and monetary policy actions will help underpin confidence and stimulate spending by consumers and businesses to restore growth. The Bank's Governing Council stands ready to adjust the scale or duration of its programs if necessary. All the Bank's actions are aimed at helping to bridge the current period of containment and create the conditions for a sustainable recovery and achievement of the inflation target over time.