The BoC's QEzzzzzz

How do you sum up the BoC's statement in one word? QEzzzzz.....

The Bank of Canada reaffirmed commitments to an extended period of being on hold at 0.25% and ongoing quantitative easing. Wording changes here and there largely cancelled out one another in terms of their overall significance to the picture that lies ahead. I think the BoC is in wait mode and will elaborate upon what they're waiting for in a moment.

There was very little market reaction, if any. The Canada two year yield didn't budge and the 10 year yield rose slightly after the statement but generally in sync with US 10s. CAD appreciated somewhat to the USD post-10amET, but oil prices also climbed at the same time and CAD is a middle of the pack performer to the USD.

On the slightly hawkish side was acknowledgement that the US and Canadian recoveries have been stronger than expected thus far. We see this in reference to the US where the BoC said the rebound "has been stronger than expected." We also see it in reference to Canada where they say the recovery in Q3 "looks to be faster than anticipated in July."

On the dovish side, the BoC reaffirmed its commitment toward continuing its QE program with an unchanged focus upon purchases of Government of Canada bonds of at least C$5B per week. They reference how they expect the initial recovery "to be followed by a protracted and uneven phase, which will be heavily reliant on policy support." They reference continued forecast ambiguity that is dependent upon the path the covid-19 virus takes from here.

To back this up, the BoC repeated its forward rate guidance that says the policy rate will remain at 0.25% "until economic slack is absorbed so that the 2 percent inflation target is sustainably achieved." They also repeated the QE guidance that the program "will continue until the recovery is well underway." That's a bit of a tough sell given their overall purchase programs stopped growing weeks ago (chart 1). Governor Macklem has previously provided a very vague definition of what this means by saying it refers to a period between the initial phase of recovery and the closure of spare capacity.

One could debate the significance of the change in the final paragraph but I don't personally think it is meaningful. The BoC said in July that "the Bank is prepared to provide further monetary stimulus as needed." Today they struck that out and instead said the QE program "will be calibrated to provide the monetary policy stimulus needed to support the recovery and achieve the inflation objective." Being prepared to add more could well be construed as meaning the same thing as calibrating the program. Plus, this is not the Fed, where markets hang in the balance on every single little wording change.

In my opinion, the Bank of Canada is in a holding pattern pending a handful of major potential developments that may determine next steps into year-end. One is how they are reading movement toward the Federal Liberal government's throne speech two weeks from today and what it potentially tees up by way of a

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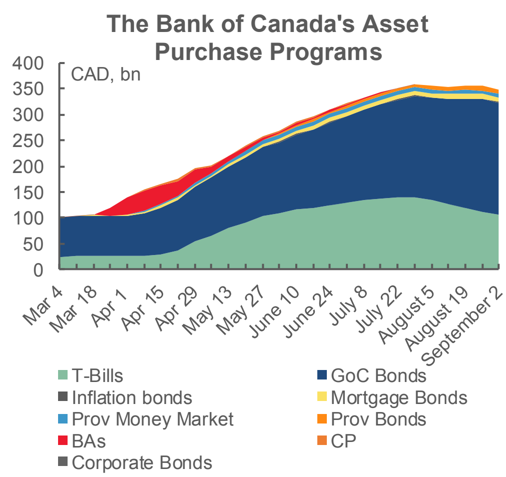
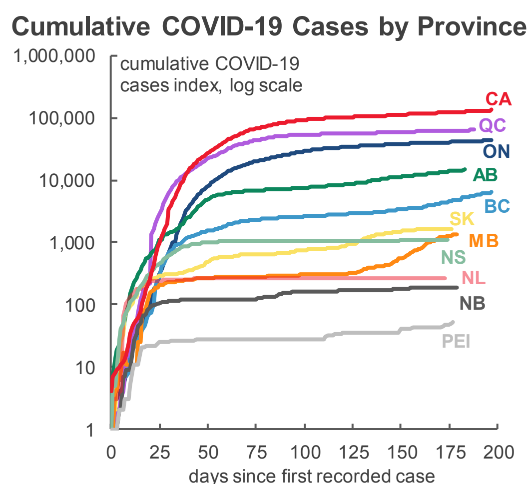
Chart 1



Sources: Scotiabank Economics, Bank of Canada.

Chart 2



Sources: Scotiabank Economics, Government of Canada.

possible further spending spree. Two is the evolution of the pandemic as Canadian cases rise particularly in western Canada (chart 2). Three is whether the faster than expected rebound of late is sustainable or results in a future pulled-forward demand vacuum that is reminiscent of what Federal fiscal stimulus and rate cuts did in 2015–17.

Until we have further clarity on these matters, the BoC is taking a nap. Hence QEzzzzz. Tomorrow's speech by Governor Macklem (12:30pmET) will be the next focus. His topic is "The uneven effects of COVID-19 on different sectors and people in the economy" which implies more of a micro than macro emphasis that could downplay progress in aggregate by pointing to areas of weakness and inequality. The press conference at 1:45pmET may carry further risk if topics like the BoC's strategic review, average inflation targeting and yield curve control are broached.

Go here for the original statement and please see the accompanying comparison of the September and July statements.

RELEASE DATE: September 9, 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. The Bank is also continuing its quantitative easing (QE) program, with large-scale asset purchases of at least $5 billion per week of Government of Canada bonds.

Both the global and Canadian economies are evolving broadly in line with the scenario in the July Monetary Policy Report (MPR), with activity bouncing back as countries lift containment measures. The Bank continues to expect this strong reopening phase to be followed by a protracted and uneven recuperation phase, which will be heavily reliant on policy support. The pace of the recovery remains highly dependent on the path of the COVID-19 pandemic and the evolution of social distancing measures required to contain its spread.

The rebound in the United States has been stronger than expected, while economic performance among emerging markets has been more mixed. Global financial conditions have remained accommodative. Although prices for some commodities have firmed, ***oil prices remain weak.***

In Canada, real GDP fell by 11.5 percent (39 percent annualized) in the second quarter, resulting in a decline of just over 13 percent in the first half of the year, largely in line with the Bank's July MPR central scenario. All components of aggregate demand weakened, as expected.

As the economy reopens, the bounce-back in activity in the third quarter looks to be faster than anticipated in July. Economic activity has been supported by government programs to replace incomes and subsidize wages. Core funding markets are functioning well, and this has led to a decline in the use of the Bank's short-term liquidity programs. Monetary policy is working to support household spending and business investment by making borrowing more affordable.

Household spending rebounded sharply over the summer, with stronger-than-expected goods consumption and housing activity largely reflecting pent-up demand. There has also been a large but uneven rebound in employment. Exports are recovering in response to strengthening foreign demand, but are still well below pre-pandemic levels. Business confidence and investment remain subdued. While recent data during the reopening phase is encouraging, the Bank continues to expect the recuperation phase to be slow and choppy as the economy copes with ongoing uncertainty and structural challenges.

CPI inflation is close to zero, with downward pressure from energy prices and travel services, and is expected to remain well below target in the near term. Measures of core inflation are between 1.3 percent and 1.9 percent, reflecting the large degree of economic slack, with the core measure most influenced by services prices showing the weakest growth.

As the economy moves from reopening to recuperation, it will continue to require extraordinary monetary policy support. The Governing Council will hold the policy interest rate at the effective lower bound until economic slack is absorbed so that the 2 percent inflation target is sustainably achieved. To reinforce this commitment and keep interest rates low across the yield curve, the Bank is continuing its large-scale asset purchase program at the current pace. This QE program will continue until the recovery is well underway ***and will be calibrated to provide the monetary policy stimulus needed to support the recovery and achieve the inflation objective.***

RELEASE DATE: July 15, 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. The Bank is also continuing its quantitative easing (QE) program, with large-scale asset purchases of at least $5 billion per week of Government of Canada bonds. The Bank's short-term liquidity programs announced since March to improve market functioning are having their intended effect and, with reduced market strains, their use has declined. The provincial and corporate bond purchase programs will continue as announced. The Bank stands ready to adjust its programs if market conditions warrant.

While economies are re-opening, the global and Canadian outlook is extremely uncertain, given the unpredictability of the course of the COVID-19 pandemic. Reflecting this, the Bank's July *Monetary Policy Report* (MPR) presents a central scenario for global and Canadian growth rather than the usual economic projections. The central scenario is based on assumptions outlined in the MPR, including that there is no widespread second wave of the virus.

After a sharp drop in the first half of 2020, global economic activity is picking up. This return to growth reflects the relaxation of necessary containment measures put in place to slow the spread of the coronavirus, combined with extraordinary fiscal and monetary policy support. As a result, financial conditions have improved. The prices of most commodities, including oil, have risen from very low levels. In the central scenario, the global economy overall shrinks by about 5 percent in 2020 and then grows by around 5 percent on average in 2021 and 2022. The timing and pace of the recovery varies among regions and could be hampered by a resurgence of infections and the limited capacity of some countries to contain the virus or support their economies.

The Canadian economy is starting to recover as it re-opens from the shutdowns needed to limit the virus spread. With economic activity in the second quarter estimated to have been 15 percent below its level at the end of 2019, this is the deepest decline in economic activity since the Great Depression, but considerably less severe than the worst scenarios presented in the April MPR. Decisive and necessary fiscal and monetary policy actions have supported incomes and kept credit flowing, cushioning the fall and laying the foundation for recovery. Since early June, the government has announced additional support programs, and extended others.

There are early signs that the reopening of businesses and pent-up demand are leading to an initial bounce-back in employment and output. In the central scenario, roughly 40 percent of the collapse in the first half of the year is made up in the third quarter. Subsequently, the Bank expects the economy's recuperation to slow as the pandemic continues to affect confidence and consumer behaviour and as the economy works through structural challenges. As a result, in the central scenario, real GDP declines by 7.8 percent in 2020 and resumes with growth of 5.1 percent in 2021 and 3.7 percent in 2022. The Bank expects economic slack to persist as the recovery in demand lags that of supply, creating significant disinflationary pressures.

CPI inflation is close to zero, pulled down by sharp declines in components such as gasoline and travel services. The Bank's core measures of inflation have drifted down, although by much less than the CPI, and are now between 1.4 and 1.9 percent. Inflation is expected to remain weak before gradually strengthening toward 2 percent as the drag from low gas prices and other temporary effects dissipates and demand recovers, reducing economic slack.

As the economy moves from reopening to recuperation, it will continue to require extraordinary monetary policy support. The Governing Council will hold the policy interest rate at the effective lower bound until economic slack is absorbed so that the 2 percent inflation target is sustainably achieved. In addition, to reinforce this commitment and keep interest rates low across the yield curve, the Bank is continuing its large-scale asset purchase program at a pace of at least $5 billion per week of Government of Canada bonds. This QE program is making borrowing more affordable for households and businesses and will continue until the recovery is well underway. ***To support the recovery and achieve the inflation objective, the Bank is prepared to provide further monetary stimulus as needed.***