

BoC Prepares for a New Vaccine World

- Did the BoC put a past due expiry date on its forecasts?

Markets paid attention to the Bank of Canada for a period of time measured in minutes before volatile US stimulus headlines took over. For the most part this statement was taken by markets as a placeholder until forecast revisions are presented in the next Monetary Policy Report on January 20th.

I may be employing some literary licence with this argument, but in my view, if there is anything interesting at all about this statement then it lies in the possibility that the BoC subtly distanced itself from the forecasts it issued on October 28th.

How so? Note the last paragraph that states “In our October projection, this does not happen until into 2023” in reference to when spare capacity is expected to shut with inflation sustainably back on the 2% target as guidance surrounding when Canadians can expect the rate hike debate to really heat up. If the BoC still held to the views expressed in October in today’s statement then presumably it would have conveyed unchanged confidence in this forecast by, for instance, removing the reference to October and indicating this to be a current view. Instead, it put a best-before date on the forecasts that may have already turned into sour milk.

This is significant to note because the arrival of vaccines much earlier than anyone had anticipated just a few weeks ago may have a marked effect on the outlook. We still won’t hear the Governor talking about raising rates for quite some time to come as Ottawa continues to focus on priming the pump, but three years? That seems a tad far fetched if the pandemic essentially comes to an end over the next year and forms of activity that were perhaps prematurely written off return earlier than previously anticipated.

In my view, debate over further tapering of bond purchases will heat up over 2021H1. That would be consistent with shutting down the purchase program well before the possible closure of the output gap as a measure of overall spare capacity around a year ahead of prior BoC guidance (chart 1).

This possibly earlier closure of the output gap should also be viewed through the same lens that sees Canada having more quickly ramped up monetary and fiscal stimulus than in the US despite having one-seventh the per capita COVID-19 case rate and core inflation closer to target than in the US (charts 2–5).

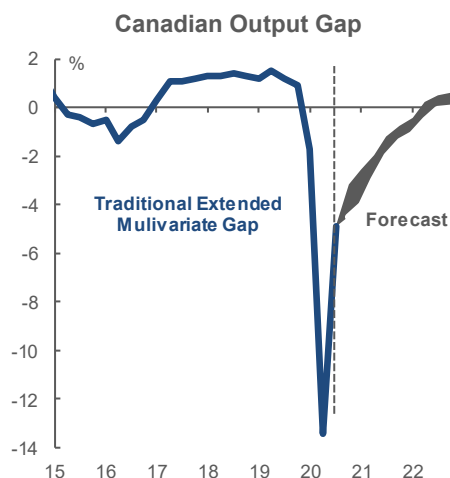
Other statement changes were relatively minor in nature and pretty much just factual in nature. Vaccines got three nods in the statement as offsets to how 2021Q1 faces greater than previously anticipated downside risk notwithstanding a stronger start to Q4 than the BoC had previously anticipated with fiscal supports expected to bridge this period of uncertainty.

What may have surprised some was that the BoC left unchanged its measure of the effective lower bound. Some clients felt that Macklem’s parliamentary testimony on November 26th may have teed up a change in the measure today when he said they could cut the ELB below 0.25% but still keep it positive as the RBA did months ago. I argued against them doing that today by noting Macklem was responding in the hypothetical to musings about the BoC’s potential further firepower if needed in a more adverse shock. That said, I have some sympathy

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Chart 1



Sources: Scotiabank Economics, Statistics Canada.

for any time markets get confused over BoC guidance on the ELB since it keeps changing its mind without offering much by way of explanation. From late 2015 until March of this year the ELB was defined as around -0.5%. The April statement redefined it as +0.25% as communications over March and April ruled out negative rates. BoC communications since then have stuck by 0.25% while nevertheless saying negative rates were in the toolkit even if not presently under consideration. In order for negative rates to be credibly viewed as in the toolkit the ELB would have to be negative.

Please see the accompanying statement comparison.

Chart 2

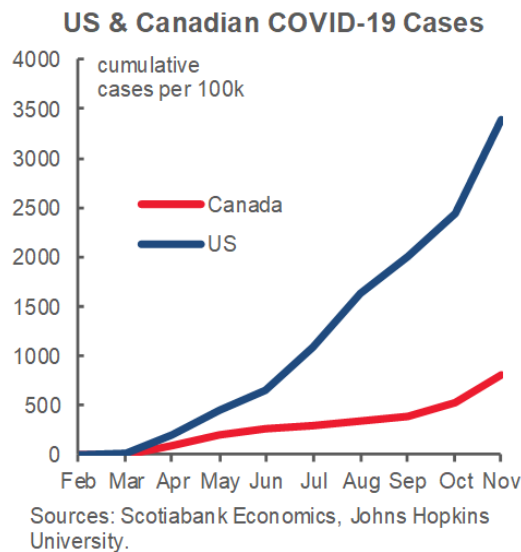


Chart 3

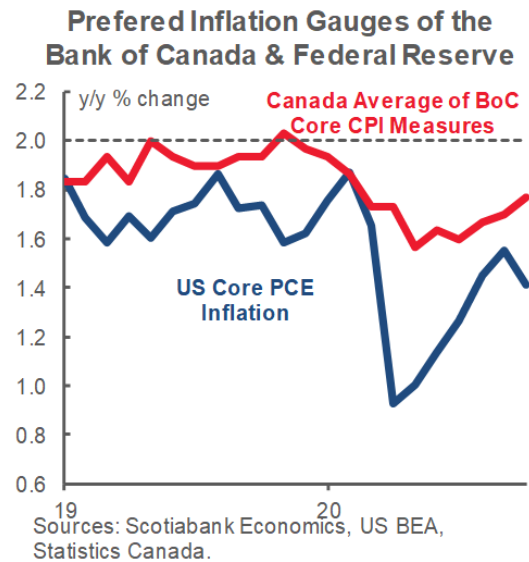


Chart 4

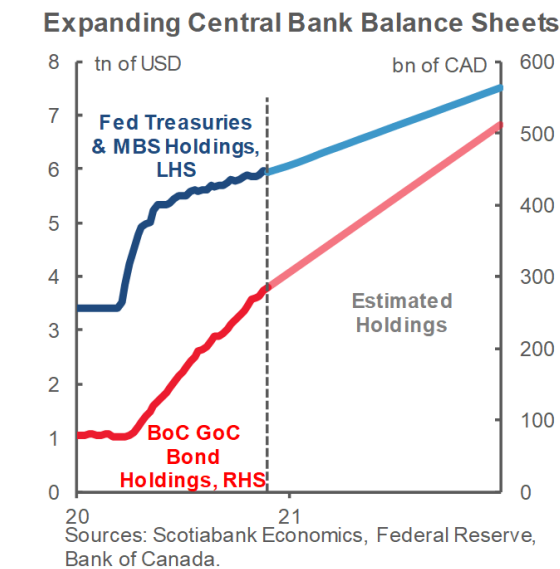
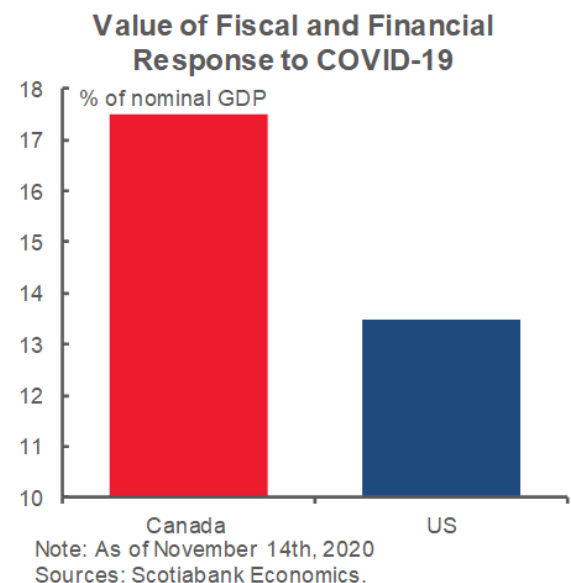


Chart 5



RELEASE DATE: December 9, 2020

The Bank of Canada today maintained its target for the overnight rate at the effective lower bound of ¼ percent, with the Bank Rate at ½ percent and the deposit rate at ¼ percent. The Bank is maintaining its extraordinary forward guidance, reinforced and supplemented by its quantitative easing (QE) program, which continues at its current pace of at least \$4 billion per week.

The rebound in the global and Canadian economies has unfolded largely as the Bank had anticipated in its October *Monetary Policy Report* (MPR). More recently, ***news on the development of effective vaccines is providing reassurance that the pandemic will end and more normal activities will resume, although the pace and breadth of the global rollout of vaccinations remain uncertain. Near term, new waves of infections are expected to set back recoveries in many parts of the world.*** Accommodative policy and financial conditions are continuing to provide support across most regions. Stronger demand is pushing up prices for most commodities, including oil. A broad-based decline in the US exchange rate has contributed to a further appreciation of the Canadian dollar.

In Canada, national accounts data for the third quarter were consistent with the Bank's expectations of a sharp economic rebound following the precipitous decline in the second quarter. The labour market continues to recoup the jobs that were lost at the start of the pandemic, albeit at a slower pace. However, activity remains highly uneven across different sectors and groups of workers. ***Economic momentum heading into the fourth quarter appears to be stronger than was expected in October but, in recent weeks, record high cases of COVID-19 in many parts of Canada are forcing re-imposition of restrictions. This can be expected to weigh on growth in the first quarter of 2021 and contribute to a choppy trajectory until a vaccine is widely available.*** The federal government's recently announced measures should help maintain business and household incomes during this second wave of the pandemic and support the recovery.

CPI inflation in October picked up to 0.7 percent, largely reflecting higher prices for fresh fruits and vegetables. While this suggests a slightly firmer track for inflation in the fourth quarter, the outlook for inflation remains in line with the October MPR projection. Measures of core inflation are all below 2 percent, and considerable economic slack is expected to continue to weigh on inflation for some time.

Canada's economic recovery 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 our October projection, this does not happen until into 2023.*** To reinforce this commitment and keep interest rates low across the yield curve, the Bank will continue its QE program until the recovery is well underway and will adjust it as required to help bring inflation back to target on a sustainable basis. We remain committed to providing the monetary policy stimulus needed to support the recovery and achieve the inflation objective.

RELEASE DATE: October 28, 2020

The Bank of Canada today maintained its target for the overnight rate at the effective lower bound of ¼ percent, with the Bank Rate at ½ percent and the deposit rate at ¼ percent. The Bank is maintaining its extraordinary forward guidance, reinforced and supplemented by its quantitative easing (QE) program. The Bank is recalibrating the QE program to shift purchases towards longer-term bonds, which have more direct influence on the borrowing rates that are most important for households and businesses. At the same time, total purchases will be gradually reduced to at least \$4 billion a week. The Governing Council judges that, with these combined adjustments, the QE program is providing at least as much monetary stimulus as before.

The global and Canadian economic outlooks have evolved largely as anticipated in the July Monetary Policy Report (MPR), with rapid expansions as economies reopened giving way to slower growth, despite considerable remaining excess capacity. Looking ahead, rising COVID-19 infections are likely to weigh on the economic outlook in many countries, and growth will continue to rely heavily on policy support.

In the United States, GDP growth rebounded strongly but appears to be slowing considerably. China's economic output is back to pre-pandemic levels and its recovery continues to broaden. Emerging-market economies have been hit harder, especially those with severe outbreaks. The recovery in Europe is slowing amid mounting lockdowns. Overall, global GDP is projected to contract by about 4 percent in 2020 before growing by just over 4 ½ percent, on average, in 2021–22.

Oil prices remain about 30 percent below pre-pandemic levels. Meanwhile, non-energy commodity prices, on average, have more than fully recovered. Despite continued low oil prices, the Canadian dollar has appreciated since July, largely reflecting a broad-based depreciation of the US dollar.

In Canada, the rebound in employment and GDP was stronger than expected as the economy reopened through the summer. The economy is now transitioning to a more moderate recuperation phase. In the fourth quarter, growth is expected to slow markedly, due in part to rising COVID-19 case numbers. The economic effects of the pandemic are highly uneven across sectors and are particularly affecting low-income workers. Recognizing these challenges, governments have extended and modified business and income support programs.

After a decline of about 5 ½ percent in 2020, the Bank expects Canada's economy to grow by almost 4 percent on average in 2021 and 2022. Growth will likely be choppy as domestic demand is influenced by the evolution of the virus and its impact on consumer and business confidence. Considering the likely long-lasting effects of the pandemic, the Bank has revised down its estimate of Canada's potential growth over the projection horizon.

CPI inflation was at 0.5 percent in September and is expected to stay below the Bank's target band of 1 to 3 percent until early 2021, largely due to low energy prices. Measures of core inflation are all below 2 percent, consistent with an economy where demand has fallen by more than supply. Inflation is expected to remain below target throughout the projection horizon.

As the economy recuperates, 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 our current projection, this does not happen until into 2023. The Bank is continuing its QE program and recalibrating it as described above. The program will continue until the recovery is well underway. We are committed to providing the monetary policy stimulus needed to support the recovery and achieve the inflation objective.

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