December 8, 2021

The BoC Met Our Expectations — For Now

- **Forward rate guidance was unchanged**
- **CAD and rates reacted dovishly…**
- **...only because some thought the BoC would pivot more hawkishly today**
- **Prior confidence in vaccines was dropped**
- **Guidance around spare capacity and inflation was little changed**
- **The BoC finally acknowledged wage pressures!**
- **Overall: See you in January with new forecasts…**
- **…and an April hike remains the earliest likely scenario**

The Bank of Canada broadly met our expectations for today's statement. However, the segment of market opinion that thought the BoC would embrace a more hawkish pivot by more explicitly setting up a January hike was surprised by it.

On net, that means the statement was taken as dovish only *relative* to market pricing that had been getting carried away and was proving to be rather inflexible in light of the omicron variant. Accordingly, the 2-year Government of Canada yield plunged by about 8bps which may have been exaggerated by positioning swings across some market participants. The whole Canadian curve is outperforming the US rates sell-off. CAD depreciated by about half a penny.

The most important point is that the BoC maintained guidance that it will only entertain a rate hike as soon as next April and not before. This is expressed by repeating unchanged forward guidance:

> "We remain committed to holding 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 the Bank's October projection, this still happens sometime in the middle quarters of 2022."

Indicating some distance from the October projections is not terribly significant since the BoC had a tendency to anchor its views at non-MPR meetings around its last forecasts. Still, we need to look at other evidence in the statement to see the degree to which they are standing by those forecasts or distancing themselves from it.

On balance, the overall tone of the statement reads like they are leaving their options open into the next forecast assessment in January.

On the neutral/dovish side, they said the following:

- Prior reference to how "vaccines are proving highly effective against the virus" is now gone. I doubt that's unintended. Everyone is in the same boat now in terms of evaluating incoming research on vaccine efficacy in response to the

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omicron variant. It doesn't mean the BoC suddenly has no confidence in vaccines and if pressed I would expect Deputy Governor Gravelle to say tomorrow that they still believe in them. But the omission likely reflects more uncertainty toward current vaccines. We simply don't know enough about it yet, but what we do know is at best offering room for cautious optimism. Omicron is likely to cut across populations very unevenly as argued in the morning note.

- Further, they continue to emphasize ongoing slack in the economy with no new reference to fresh thoughts around potential GDP. We see this where they state GDP was still 1½% below 2019Q4 by 2021Q3.
- They also say it in the output gap and inflation guidance which is unchanged. The BoC still expects inflation to "ease back towards 2 percent in the second half" of 2022. They did not amplify inflation concerns, but bear in mind that buried within their forecasts is their assumed reaction function on rates and other policy variables in order to achieve such an outcome. Also bear in mind that the BoC has blown its inflation forecasts to date and historically always says they'll achieve their inflation target and so take that with a mountain of salt. In any event, returning toward target is still compatible with rate hikes since if everything else is at or approaching equilibrium then a more neutral policy rate should be as well.
- On the back of strong job reports, they now say that employment is "back to its pre-pandemic level." This might be quibbling somewhat, but no, employment is actually 186,000 jobs above where it stood in February 2020 or about 1% higher. That's nothing to scoff at in my opinion. There are obvious sensitivities around how the BoC judges labour market conditions given the pending strategic review's conclusions and their communication by Governor Macklem and Finance Minister Freeland. We're already at full employment in my view and don't need to be tinkering with the BoC's mandate at such a cyclical sensitive point in the cycle without courting a new kind of risks.

On the hawkish side, we have the following:

- The statement acknowledges that "wage growth has also picked up." Finally! Someone else is saying what I've been saying for many months now! That said, it raises further questions. A big one is whether the BoC is indicating renewed confidence in the LFS wages measure and also emphasizing rising unit labour costs, while distancing itself from the slow moving and lagging 'wage common' measure that former Governor Poloz introduced. Further, if the BoC is now acknowledging wage pressures, then does that mean it is now more concerned about reinforcing wage-price effects?
- They repeated that they are "closely watching inflation expectations and labour costs to ensure that the forces pushing up prices do not become embedded in ongoing inflation." Recall the evidence from the BoC's consumer and business surveys with respect to rising inflation expectations plus recall evidence on rising wage inflation. The BoC is saying that if such pressures are further amplified then they'll respond more hawkishly. Omicron is rather unlikely to help labour scarcity (and hence wage pressures) or supply chain challenges (and hence inflation).

Overall, the BoC did indeed resist spitting in anyone's holiday 'nog today. They stayed on track with guidance to begin entertaining rate hikes as soon as next April. Now they can sit back and assess incoming evidence on multiple fronts and reassess at the January 26th 2022 meeting when they'll have their next chance to revise forecasts. By then we should have much more information around the omicron variant and its effects plus Canadian fiscal policy and broader tracking of incoming data and events.

Next up will be DepGov Gravelle's *Economic Progress Report* tomorrow at 2pmET followed by a press conference at ~3:15pmET. He could just stick to repeating today's guidance and updating tracking of how the economy and inflation have been performing, but Gravelle heads the financial markets division at the BoC and the last time he spoke way back in March was about balance sheet dynamics. There are still unanswered questions around balance sheet management going forward but it's unclear whether the BoC is prepared to provide greater guidance at this stage or closer to the first hike.

Please see the attached statement comparison.

RELEASE DATE: December 8, 2021

The Bank of Canada today held 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's extraordinary forward guidance on the path for the overnight rate is being maintained. ***The Bank is continuing its reinvestment phase, keeping its overall holdings of Government of Canada bonds roughly constant.***

The global economy continues to recover from the effects of the COVID-19 pandemic. Economic growth in the United States has accelerated, led by consumption, while growth in some other regions is moderating after a strong third quarter. Inflation has increased further in many countries, reflecting strong demand for goods amid ongoing supply disruptions. ***The new Omicron COVID-19 variant has prompted a tightening of travel restrictions in many countries and a decline in oil prices, and has injected renewed uncertainty.*** Accommodative financial conditions are still supporting economic activity.

Canada's economy grew by about 5½ percent in the third quarter, as expected. Together with a downward revision to the second quarter, this brings the level of GDP to about 1½ percent below its level in the last quarter of 2019, before the pandemic began. Third-quarter growth was led by a rebound in consumption, particularly services, as restrictions were further eased and higher vaccination rates improved confidence. Persistent supply bottlenecks continued to inhibit growth in other components of GDP, including non-commodity exports and business investment.

Recent economic indicators suggest the economy had considerable momentum into the fourth quarter. This includes broad-based job gains in recent months that have brought the employment rate essentially back to its pre-pandemic level. Job vacancies remain elevated and wage growth has also picked up. Housing activity had been moderating, but appears to be regaining strength, notably in resales. The devastating floods in British Columbia and uncertainties arising from the Omicron variant could weigh on growth by compounding supply chain disruptions and reducing demand for some services.

CPI inflation is elevated and the impact of global supply constraints is feeding through to a broader range of goods prices. The effects of these constraints on prices will likely take some time to work their way through, given existing supply backlogs. Gasoline prices, which had been a major factor pushing up CPI inflation, have recently declined. Meanwhile, core measures of inflation are little changed since September. The Bank continues to expect CPI inflation to remain elevated in the first half of 2022 and ease back towards 2 percent in the second half of the year. The Bank is closely watching inflation expectations and labour costs to ensure that the forces pushing up prices do not become embedded in ongoing inflation.

The Governing Council judges that in view of ongoing excess capacity, the economy continues to require considerable monetary policy support. We remain committed to holding 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 the Bank's October projection, this happens sometime in the middle quarters of 2022. We will provide the appropriate degree of monetary policy stimulus to support the recovery and achieve the inflation target.

RELEASE DATE: October 27, 2021

The Bank of Canada today held 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's extraordinary forward guidance on the path for the overnight rate is being maintained. ***The Bank is ending quantitative easing (QE) and moving into the reinvestment phase, during which it will purchase Government of Canada bonds solely to replace maturing bonds.***

The global economic recovery from the COVID-19 pandemic is progressing. ***Vaccines are proving highly effective against the virus***, although their availability and distribution globally remain uneven and COVID variants pose risks to health and economic activity. In the face of strong global demand for goods, pandemic-related disruptions to production and transportation are constraining growth. Inflation rates have increased in many countries, boosted by these supply bottlenecks and by higher energy prices. While bond yields have risen in recent weeks, financial conditions remain accommodative and continue to support economic activity.

The Bank projects global GDP will grow by 6½ percent in 2021 – a strong pace but less than projected in the July *Monetary Policy Report* (MPR) – and by 4¼ percent in 2022 and about 3½ percent in 2023.

In Canada, ***robust economic growth has resumed, following a pause in the second quarter.*** Strong employment gains in recent months were concentrated in hard-to-distance sectors and among workers most affected by lockdowns. This has significantly reduced the very uneven impact of the pandemic on workers. As the economy reopens, it is taking time for workers to find the right jobs and for employers to hire people with the right skills. This is contributing to labour shortages in certain sectors, even as slack remains in the overall labour market.

The Bank now forecasts Canada's economy will grow by 5 percent this year before moderating to 4¼ percent in 2022 and 3¾ percent in 2023. Demand is expected to be supported by strong consumption and business investment, and a rebound in exports as the US economy continues to recover. Housing activity has moderated, but is expected to remain elevated. On the supply side, shortages of manufacturing inputs, transportation bottlenecks, and difficulties in matching jobs to workers are limiting the economy's productive capacity. Although the impact and persistence of these supply factors are hard to quantify, the output gap is likely to be narrower than the Bank had forecast in July.

The recent increase in CPI inflation was anticipated in July, but ***the main forces pushing up prices – higher energy prices and pandemic-related supply bottlenecks – now appear to be stronger and more persistent than expected.*** Core measures of inflation have also risen, but by less than the CPI. The Bank now expects CPI inflation to be elevated into next year, and ease back to around the 2 percent target by late 2022. The Bank is closely watching inflation expectations and labour costs to ensure that the temporary forces pushing up prices do not become embedded in ongoing inflation.

The Governing Council judges that in view of ongoing excess capacity, the economy continues to require ***considerable*** monetary policy support. We remain committed to holding 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 the Bank's projection, ***this happens sometime in the middle quarters of 2022.*** In light of the progress made in the economic recovery, the Governing Council has decided to end quantitative easing and keep its overall holdings of Government of Canada bonds roughly constant.

We will continue to provide the appropriate degree of monetary policy stimulus to support the recovery and achieve the inflation target.