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GLOBAL ECONOMICS

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BoC Rules Out Near-Term Easing — And It's Standing On Guard Into Springtime

- **The BoC held its policy rate...**
- **...basically ruled out a cut in April...**
- **...and set a high bar against Springtime easing**
- **QT plans remain intact, but dubiously so**
- **The presser offered useful insights into a range of considerations**

The Bank of Canada met our expectations for it to lean against any sentiment it was moving toward easing policy in the near-term. Advice to pay nearer term contracts continues to pay off for institutional clients and we remain comfortable with a call for the first cut to be delivered only by the September meeting and a lot has to go right to even get to that.

The broad takeaways include basically ruling out easing in April while setting a high bar to act any time soon thereafter alongside a more explicit warning on the Spring housing market and the current government Budget season. I was surprised by the explicit move to rule out changes to Quantitative Tightening plans and will address this further below, but for now it's a hawkish message for the rest of the term structure on a relative rates basis compared to the Federal Reserve's likely moves.

A recap of changes to the statement, key aspects of Governor Macklem's opening remarks and a full transcript of the insights that were offered in the press conference follow on a topic-by-topic basis. It flows from coverage for our market operations and clients.

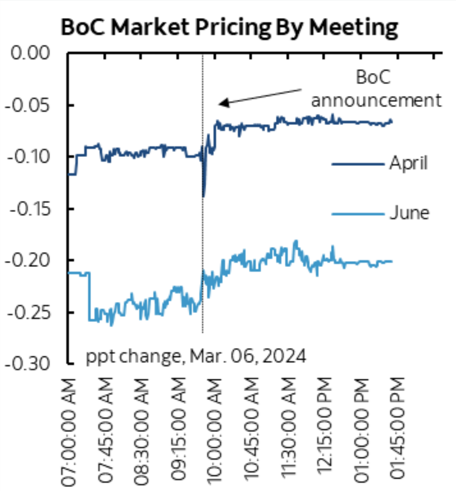
MARKET REACTION—CUTS PUSHED OUT AGAIN

See charts 1–3. Canada's front-end is underperforming the US on net through the whole sequence of developments since the 9:45amET statement. The Canada 2-year yield is up 5bps since the 9:45amET statement. CAD appreciated by about half a cent to the USD. April's meeting pricing was further reduced with now only 6–7bps of a cut priced. June's pricing was also trimmed back from nearly a full quarter point cut to 18–19bps. I would still pay those contracts even though they've moved lower in line with expectations.

THERE WERE FEW STATEMENT CHANGES

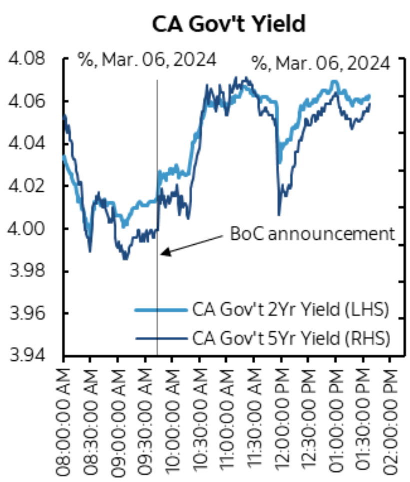
It was a very short statement with only 380 words and that probably says more than anything else in the sense that they are clearly on the sidelines awaiting more evidence

Chart 1



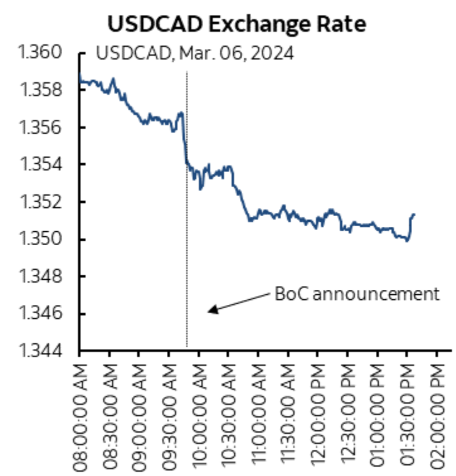
Sources: Scotiabank Economics, Bloomberg.

Chart 2



Sources: Scotiabank Economics, Bloomberg.

Chart 3



Sources: Scotiabank Economics, Bloomberg.

before deciding what to do at which point I'm sure they'll be more verbose. For now, most of the talking was left to the presser. Please see the statement comparison in the appendix

Key is that they left the final paragraph completely intact as expected. The implication is that there is no effort to tee up easing in the nearer term. Here it is:

> "The Council is still concerned about risks to the outlook for inflation, particularly the persistence in underlying inflation. Governing Council wants to see further and sustained easing in core inflation and continues to focus on the balance between demand and supply in the economy, inflation expectations, wage growth, and corporate pricing behaviour."

There was also a reference to how "…there are now some signs that wage pressures may be easing." Oh really? I'll come back to my skepticism later in this note.

One thing that was odd about the BoC statement was the numerous references to Q4 that felt dated relative to fresher developments. They say that inflation in the US has continued to ease, as if the January core CPI and core PCE prints never happened. Maybe they're looking at year-over-year rates but that makes no sense if one is evaluating pressures at the margin.

GOVERNOR MACKLEM'S OPENING REMARKS RULED OUT APRIL

Governor Macklem's opening remarks are **here**. There are a few things worth noting.

First is that Macklem signalled they are looking through data on inflation, growth and jobs since the January 24th decision. Here's the quote:

> "In the six weeks since our January decision, there have been no big surprises."

Macklem's remarks repeated prior emphasis upon how the policy rate was "high enough" to restore price stability but that "we could not rule out the need to raise rates further if there were new inflation surprises" and that the discussion as shifting to "how long it [ed. the policy rate] needs to stay at the current level." That's not new.

The remarks also looked through the soft core inflation reading for January:

> "Our preferred measures of core inflation eased in January but remain above 3% on a year-over-year and three-month basis. As well, the share of CPI components rising faster than 3% declined but is still above the historical average."

and

> "Underlying inflationary pressures persist: year-over-year and three-month measures of core inflation are in the 3% to 3.5% range, and the share of CPI components growing above 3% declined but is still above the historical average. "

There is also nothing here that says they are open to cutting in April. In fact, this reference makes it clear by way of the plural emphasis on 'months' since we only get one more inflation report before the April 10th decision:

> "Governing Council remains concerned about the persistence of underlying inflation, and we want to see a further deceleration in core inflation in the coming months."

There will be just one more inflation reading before the April meeting and three CPI reports before the June meeting. That comment therefore rules out April unless they communicated poorly on the matter, but it keeps all meetings from June onward 'live.' I continue to doubt they will have comfort to ease at that point given persistent upside risk to inflation.

The opening remarks continued to flag that "underlying price pressures persist" and Governing Council is "concerned about the persistence of underlying inflation" amid ongoing "upside risks to inflation." Macklem said "Looking ahead, we continue to expect inflation will be close to 3% through the middle of the year before easing in the second half."

None of that is the language of a central bank moving toward easing anytime soon.

THE BOC IS STICKING TO ITS QT PLANS

While there was only one reference to quantitative easing in the opening remarks, any appetite for altering QT plans earlier than previously guided was ruled out in the press conference. That might explain some of the Canada curve's underperformance relative to the US today as the BoC is saying they will continue to foist bonds back into markets while the Fed gradually moves in the other direction.

All that the statement itself said was that "We are also continuing our policy of quantitative tightening."

Macklem was asked during the press conference to address the issue further and I have to admit I'm surprised that he scooped Deputy Governor Gravelle's appearance on the 21st. Ticket holders to that event may as well ask for refunds now because the speech on balance sheet management was pre-empted by Macklem and his SDG Rogers.

When asked is the QT program nearing an end and could it be wound down earlier than previously signalled after a series of other measures have been pursued to address funding market challenges, Macklem and Rogers tag-teamed to say the following:

> "As you highlighted, we did a series of overnight repo operations because the overnight rate was under upward pressure compared to the target rate. We came in to relieve that pressure. We did those operations 13 times in January but not since which indicates that pressure has gone away. We also restarted receiver general auctions, but the uptake hasn't been super strong which also suggests that problem has gone away. We don't think QT was the driver of those problems. You shouldn't take those signs as evidence that we need to end QT earlier. Those earlier pressures pushed the demand for long bonds up on rate cut expectations on leverage and so the demand for funding was up. Our view on our QT strategy hasn't really changed significantly. So far QT has gone very smoothly. Our balance sheet is 40% smaller during QT. We'll give advance notice if our strategy changes."

I don't agree on the root causes of the spread pressure that are incomplete. QT played a role in driving funding market strains in the US and Canada. I think the reasons why CORRA over o/n narrowed were a) due to the signalling in the measures they applied (repo, receiver general auctions, cash mgmt bills) that was more powerful than the take-up, and b) potential spillover effects from the Fed that itself doesn't sound like it's in a hurry but is moving toward scaling back on QT. The BoC will never admit this, but the fact its big brother is moving toward eventually lessening strains on N.A. funding markets probably matters much more than anything that the BoC's relatively small influence might achieve.

But I still think this is tbc. The BoC is targeting settlement balances at 1–2% of GDP versus the Fed's reserves to GDP target at 10–12% of NGDP. Canada is special. It's banking system is special and more stable. But it's not that special. We'll see how this experiment to push down settlement balances for the rest of the year unfolds especially against potentially stronger nearer-term funding requirements partly related to the mortgage book and how that impacts funding market pressures.

Regardless, sticking to an unchanged QT timeline is a sign they are also in zero rush to ease on the policy rate. Both are looking like late year developments imo.

A HOT SPRING HOUSING MARKET AND FISCAL STIMULUS WOULDN'T BE IGNORED

A series of questions explore these issues.

First, Macklem was asked if he would be comfortable lowering rates on April 10th before the Federal budget is tabled on April 16th after the next decision and hence before seeing the government's spending plans and gave a weak answer at first:

> "We'll take all the information into account. We'll have the decision at the next one."

I'm glad that another journalist thought that answer was inadequate and came back with another question by asking if strong housing and heavy government spending come together, then what would that mean to your outlook and progress? Macklem said:

> "You're getting into the hypothetical range. If housing and government spending were stronger then growth would be stronger and so would inflation pressures and we would have to take that into account in our interest rate setting."

That's not hypothetical, Governor. It's your job. That said, I'm glad he made it very clear to everyone that a hot Spring housing market and more fiscal pump-priming wouldn't be ignored. The inference that I draw from this is that it would delay easing, or lessen the magnitude of potential easing, or reopen hike risk.

Another question took this further by asking "Are you trying to keep rates at an elevated level to coincide with the Spring housing market to ensure that activity doesn't pick up too rapidly and put further upward pressure on inflation?" Macklem said:

> "Coming back to housing, we did highlight that there are some risks that the housing market could reaccelerate. The contribution of housing to activity has been slowing [ed. until Q4….] and we expect some rebound in housing in our projection. Could that rebound be stronger than we expected? Yes it could. That is an upside risk. But as I said earlier there are other risks and we're looking at the balance of risks overall and looking at the whole economy."

The short answer is yes, a hot Spring housing market and more fiscal pump-priming would drive the BoC to reassess among other parts of the picture and that's the narrative I've been driving on the BoC for a while now.

THE BOC STOOD BY ITS INFLATION FORECAST

It was noted by a journalist that one forecaster, the Parliamentary Budget Officer, expects inflation to be back to the 2% target by the end of the year and that we should be seeing a drop in rates by April. Macklem was asked if he agreed. His answer was basically nope:

> "Forecasting questions are for the PBO. We have published our forecasts in January. As I pointed out this morning, there were no major surprises since January. We are anticipating inflation to hover around 3% for the first half of this year and it should decline gradually over the second half of the year. We are not forecasting to have inflation at 2% at the end of the year. In January we forecast this would not happen until 2025."

Clearly the PBO has some forecast revisions to consider as their forecast rate cut is too early. Therefore their forecast for growth may be too high and for interest expense in the Federal Budget to be perhaps too low.

ARE YOU NOT EASING BECAUSE OF SHELTER INFLATION?

When asked whether shelter price inflation is playing in their decision to hold the policy rate and guide against nearer-term easing, Macklem said yes but that was just one part of broader pressures they are concerned about. That's key because other shops have been misleading in efforts to dismiss inflation as only being driven by shelter:

> "Housing's a big part of the economy. Yes, shelter price inflation is the biggest contributor to inflation right now. It's certainly weighing on our decisions. Having said that, our target is total inflation. If you look beyond shelter, underlying inflation is still under pressure. Our core measures are still running 3–3.5% on a 12 month and 3-month basis. Shelter is impacting inflation but there are other underlying pressures on inflation."

FORWARD GUIDANCE: WILL THEY TELL US BEFORE HIKING?

Macklem was asked "How much forward guidance will you provide before you decide to move rates? Or will you just move to cutting without providing guidance?"

He basically said nope, just pay attention, and told us forecasters and market participants to do our jobs absent explicit hand holding:

> "We're very clear in what we are seeing in the data, how we expect it to evolve, and what indicators we are watching. That helps people understand how things are evolving relative to our forecasts. Even if we're not out there giving new assessments, Canadians will be able to see if things are evolving as expected. We don't give forward guidance on our forward guidance so I can't say what we'll say in our next meeting. We want to give Canadians as much information as we have but we also don't want to give a sense of false precision. We're seeing progress but we need to see more. We can't put it on a calendar. We're taking it one decision at a time as we balance the risks."

AT WHAT PACE WOULD YOU EASE?

The question was "How would you view the pace of rate cuts? Can you see cuts and pauses?" That's likely a reference to, say, the preferred approach of Atlanta Fed President Bostic who said he can see a cut and then a pause.

Macklem said:

> "You're getting a little ahead of yourself here. When we get to that point we'll have more to say. It's safe to say we're not going to be lowering rates at the pace we raised them. Let's get the first decision on when to cut before addressing pace."

It's probably not much of a surprise to anyone, but the useful part of that answer is that the way down is not viewed as being symmetrical to the way up in terms of the size and pace of moves. The guidance—for now at least—implies that the BoC is thinking of a plodding quarter-point pace of easing along an uncertain path.

WHAT ARE THE UPSIDE RISKS TO INFLATION?

Macklem was asked to expand on upside risks to inflation and the ones that worry him the most. He said:

> "There are attacks in the Red Sea affecting global transportation costs. So far the effect has not been very large. They're obviously risks that oil markets could be disrupted and move sharply higher but so far that has not happened. Certainly the risk is out there

that these things escalate. Domestically, the risks really come down to the stickiness of underlying inflation. We are seeing a gradual easing in underlying inflationary pressures but the risk is that stalls and we don't get back to 2%. That's why we are looking for further and sustained downward pressure."

Clearly that's a rather incomplete list! Wage growth is still obscenely excessive in relation to tumbling productivity. Fiscal policy is likely to complete the current Budget season with a heavy amount of fiscal pump-priming that adds to growth and capacity strains. Immigration is excessive especially in relation to inadequate housing and infrastructure. The tiny move toward excess supply conditions is too small and slow to matter against other forces thus far. CAD remains undervalued. And on and on…

ARE YOUR CORE INFLATION MEASURES MISLEADING?

A journalist noted that some economists think the BoC's core inflation measures have become misleading and asked "Are you concerned? Do you need a new measure of core inflation?" Macklem dismissed this line of inquiry by saying:

"We've been using underlying inflation in a whole range of indicators instead of being fixated on one measure. Our preferred measures of core inflation are important and we're looking for further and sustained easing. We also look at other measures of core inflation. We are also looking at the whole distribution of price changes. Still about 45% of CPI components are rising by faster than 3%. When you're at 2% inflation it's usually about 25% of the basket that is above 3% which indicates there is still some broad-based pressure. We are also looking at the balance between demand and supply and wage growth and corporate pricing behaviour. We're looking for a high degree of consistency across those indicators. We need to look at all the evidence. Our core measures are prominent but we're looking at a broader range of measures."

I'm personally of the belief that other shops that are besmirching the BoC's preferred inflation readings are doing so by starting with the prior that they would be helped by imminent easing and are forcing an argument to try to justify this stance. That's putting the donkey before the cart.

WHAT DO YOU NEED TO SEE ON CORE INFLATION?

"What would satisfy the Bank on core inflation to merit easing?" Macklem said:

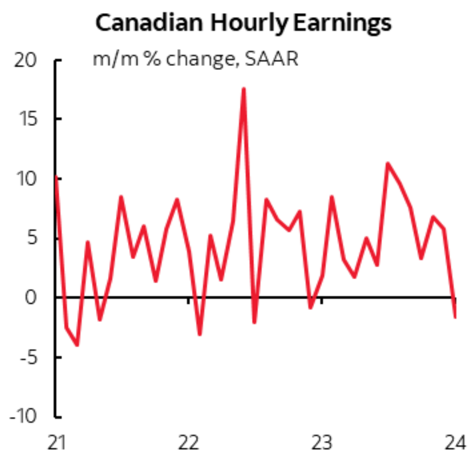
"Right now we see trimmed mean and weighted median CPI at 3.3–3.4 y/y and on a 3-month basis they're running at about the same rate. We do need to see further easing in core inflation. One month doesn't make a trend. You need to see a few months. We're looking at a whole range of indicators and not just the preferred core inflation measures.

THEY STILL VIEW LABOUR MARKETS AS COMING BACK INTO BALANCE

Macklem was asked to expand upon his views on the labour market. He said what he has basically said before:

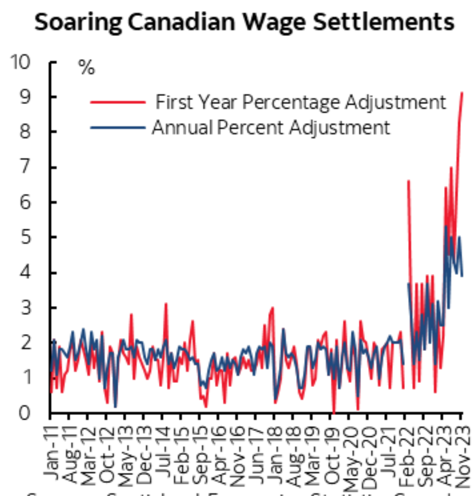
"We were in a situation that the labour market was very overheated across a

Chart 4



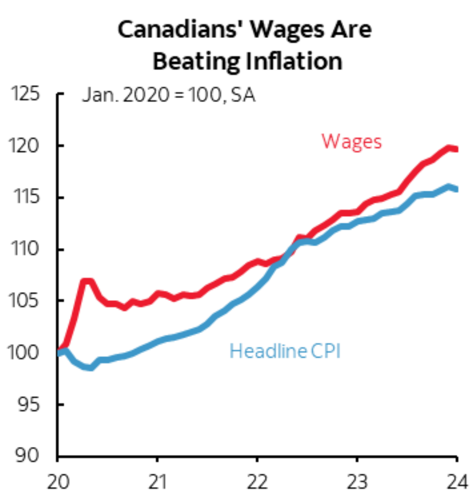
Sources: Scotiabank Economics, Statistics Canada, Haver.

Chart 5



Sources: Scotiabank Economics, Statistics Canada.

Chart 6



Sources: Scotiabank Economics, Statistics Canada.

Chart 7

Sources: Scotiabank Economics, Statistics Canada.

> whole range of measures. The labour market has come back into better balance. Vacancies were very high and have come back to more normal levels. The employment rate was at an all-time historic low and has moved up but is still low. There are some early signs that wage growth has begun to ease. We are looking for more signs. If you look at labour market indicators overall, what you see is that the labour market is coming back into better balance. Also, so far, we've brought inflation down a lot without a recession or large increase in unemployment. The labour market adjustment has been relatively smooth and gradual and the hope is that we can continue to achieve further progress on low inflation without causing any major disruption to the economy."

What I don't get is why the BoC would have said they think there are 'signs' that wage growth is ebbing. Based upon what, the single month's softening of m/m average hourly earnings in January (chart 4)? That's a low bar. You certainly can't make such a claim in relation to ginormous demands in collective bargaining exercises (chart 5). And wages continue to outpace inflation (chart 6). I suppose you could say that productivity improved in Q4, but getting overly excited by that would seem to be ridiculous in relation to the long-term trend (chart 7).

WHAT ABOUT THE US ECONOMY?

The question here was 'You noted surprisingly strong US growth. How has no-landing in the US affect your decision?' and Macklem said:

> "The most direct effect is on exports. We have been surprised by the US strength. It is slowing but the whole path has been higher than we expected which is creating stronger demand for Canadian exports. You take overall growth in Canada that was close to zero has given a chance for the economy to move to modest excess supply."

DO YOU HAVE COMMERCIAL REAL ESTATE WORRIES?

When asked whether the BoC is concerned about commercial real estate for the economy going forward and how it might affect the BoC, Rogers answered:

> "We definitely got our eye on commercial real estate. It's not the same as it is in the US. A lot of it is held by mid-tier banks [ed. in the US]. We haven't seen the same reset in valuations. We have our financial stability report coming out in early May and will have more to say."

That was pretty light in my opinion given the concerns clients have on the matter. I mean, the BoC has had ages to address this and is still saying they'll have something in another couple of months.

ARE YOU CONCERNED ABOUT STOCK MARKET EXUBERANCE?

Here the question was "If the stock market is a bubble then would it make your policy making more difficult going forward?"

Rogers said "There does seem to be some exuberance in equities. We don't forecast stock prices. Markets are doing the same thing in evaluating when we'll see a pivot to lower rates."

Suffice it to say that I wouldn't be taking stock market tips from the BoC any time soon. I don't think the BoC has much of a grasp for what's going on in the stock market. One consideration is the market's struggles with evaluating the impact of technological change that in the long run probably matters an awful lot more to wealth creation than anything that the little ol' BoC may or may not do.

RELEASE DATE: March 6, 2024

The Bank of Canada today held its target for the overnight rate at 5%, with the Bank Rate at 5¼% and the deposit rate at 5%. The Bank is continuing its policy of quantitative tightening.

Global economic growth slowed in the fourth quarter. US GDP growth also slowed but remained surprisingly robust and broad-based, with solid contributions from consumption and exports. Euro area economic growth was flat at the end of the year after contracting in the third quarter. Inflation in the United States and the euro area continued to ease. Bond yields have increased since January while corporate credit spreads have narrowed. Equity markets have risen sharply. Global oil prices are slightly higher than what was assumed in the January *Monetary Policy Report* (MPR).

In Canada, the economy grew in the fourth quarter by more than expected, although the pace remained weak and below potential. Real GDP expanded by 1% after contracting 0.5% in the third quarter. Consumption was up a modest 1%, and final domestic demand contracted with a large decline in business investment. A strong increase in exports boosted growth. Employment continues to grow more slowly than the population, ***and there are now some signs that wage pressures may be easing.*** Overall, the data point to an economy in modest excess supply.

CPI inflation eased to 2.9% in January, as goods price inflation moderated further. Shelter price inflation remains elevated and is the biggest contributor to inflation. Underlying inflationary pressures persist: year-over-year and three-month measures of core inflation are in the 3% to 3.5% range, and the share of CPI components growing above 3% declined but is still above the historical average. The Bank continues to expect inflation to remain close to 3% during the first half of this year before gradually easing.

Governing Council decided to hold the policy rate at 5% and to continue to normalize the Bank's balance sheet. The Council is still concerned about risks to the outlook for inflation, particularly the persistence in underlying inflation. Governing Council wants to see further and sustained easing in core inflation and continues to focus on the balance between demand and supply in the economy, inflation expectations, wage growth, and corporate pricing behaviour. The Bank remains resolute in its commitment to restoring price stability for Canadians.

RELEASE DATE: January 24, 2024

The Bank of Canada today held its target for the overnight rate at 5%, with the Bank Rate at 5¼% and the deposit rate at 5%. The Bank is continuing its policy of quantitative tightening.

Global economic growth continues to slow, with inflation easing gradually across most economies. While growth in the United States has been stronger than expected, it is anticipated to slow in 2024, with weakening consumer spending and business investment. In the euro area, the economy looks to be in a mild contraction. In China, low consumer confidence and policy uncertainty will likely restrain activity. Meanwhile, oil prices are about $10 per barrel lower than was assumed in the October Monetary Policy Report (MPR). Financial conditions have eased, largely reversing the tightening that occurred last autumn.

The Bank now forecasts global GDP growth of 2½% in 2024 and 2¾% in 2025, following 2023's 3% pace. With softer growth this year, inflation rates in most advanced economies are expected to come down slowly, reaching central bank targets in 2025.

In Canada, the economy has stalled since the middle of 2023 and growth will likely remain close to zero through the first quarter of 2024. Consumers have pulled back their spending in response to higher prices and interest rates, and business investment has contracted. With weak growth, supply has caught up with demand and the economy now looks to be operating in modest excess supply. Labour market conditions have eased, with job vacancies returning to near pre-pandemic levels and new jobs being created at a slower rate than population growth. However, wages are still rising around 4% to 5%.

Economic growth is expected to strengthen gradually around the middle of 2024. In the second half of 2024, household spending will likely pick up and exports and business investment should get a boost from recovering foreign demand. Spending by governments contributes materially to growth through the year. Overall, the Bank forecasts GDP growth of 0.8% in 2024 and 2.4% in 2025, roughly unchanged from its October projection.

CPI inflation ended the year at 3.4%. Shelter costs remain the biggest contributor to above-target inflation. The Bank expects inflation to remain close to 3% during the first half of this year before gradually easing, returning to the 2% target in 2025. While the slowdown in demand is reducing price pressures in a broader number of CPI components and corporate pricing behaviour continues to normalize, core measures of inflation are not showing sustained declines.

Given the outlook, Governing Council decided to hold the policy rate at 5% and to continue to *normalize the Bank's balance sheet. The Council is still concerned about risks to the outlook for inflation, particularly the persistence in underlying inflation. Governing Council wants to see further and sustained* easing in core inflation and continues to focus on the balance between demand and supply in the economy, inflation expectations, wage growth, and corporate pricing behaviour. The Bank remains resolute in its commitment to restoring price stability for Canadians.