Bank of Canada preview: Macklem on tiptoes

No fireworks are expected at Tiff Macklem's first meeting as Bank of Canada Governor, as some improvements in data (today's payrolls being a case in point) offer a reason to pause. While negative rates appear off the table, more stimulus may not be necessary for now. Any impact on the Canadian dollar is set to be short-lived

Good data, but lingering uncertainty on the economic backdrop

The Bank of Canada's policy rate has been held at what has been termed its "effective lower bound" of 0.25% since late March. This followed three quick-fire 50 basis point rate cuts in the space of just four weeks, as the scale of the crisis and the potential ramifications for the economy quickly became apparent.

At the last meeting, policymakers said the economy had hit bottom, but "uncertainty around how the recovery will unfold remains high", suggesting it was likely to be "protracted and even". Since the 3 June meeting, the newsflow on the economy has been broadly positive. Employment rose 290,000 in May and almost 1M in June, despite fears we would see another large drop, while high frequency consumer and business sentiment indicators have moved higher, and housing starts have jumped.

Amid this encouraging backdrop, comments from officials have been cautiously optimistic. New Governor Tiff Macklem – this will be his first active meeting since taking charge of the bank – talked in late June of a swift initial recovery that will likely give way to more modest growth beyond the reopening phase. He also expects to see “a lot” of downward pressure on inflation.

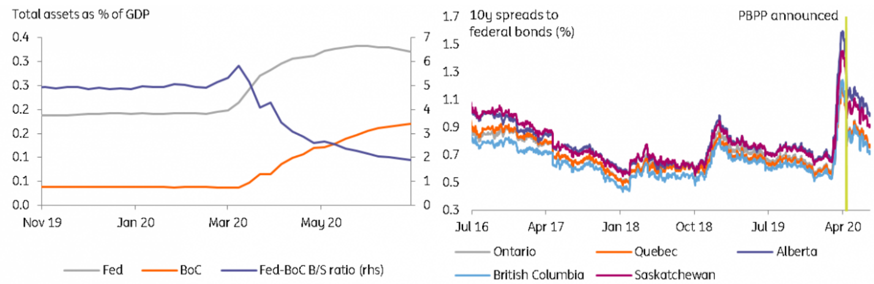
No rush for more stimulus

With negative interest rates not being seriously considered, this suggests the policy rate will remain at 0.25% for a prolonged period – perhaps two years in our view – with any additional support most likely to come through additional asset purchases. However, we don't think there is any urgency for a policy change via this tool.

The number of facilities already being put in place by the Bank of Canada appears to be providing the right amount of support. Along with a number of facilities to ensure short-term liquidity, the BoC has activated programmes to buy government, provincial and corporate bonds.

The Government of Canada Bond Purchase Program (GBPP) has been set to purchase a minimum of CAD 5 billion per week of bonds, which has contributed to a significant increase in the BoC's total assets – from 4% (before the pandemic) to 17% of GDP. To be sure, the Fed’s assets-to-GDP ratio is around 34%, but in relative terms, the BoC's balance sheet has expanded more rapidly than the Fed’s (Figure 1).

Fig. 1 & 2 - BoC assets and Canadian provincial spreads



Source: ING, Bloomberg, BoC

The BoC also appears to have successfully tackled the provincial spreads issue through the Provincial Bond Purchase Program (PBPP), which has so far purchased a total of CAD 5bn in provincial bonds. As shown in Figure 2, the 10Y spreads to federal bonds of the main Canadian provinces have moved back to more normal values and a top-up to the PBPP does not appear urgent either.

CAD: BoC's stance is not a big driver now

The Canadian dollar has trailed its procyclical peers despite hints of an economic recovery in Canada and stabilising oil prices. The flare-up in Covid-19 cases in the US has likely taken away some attractiveness from CAD due to the large exposure of Canada to new lockdown measures/prolonged economic strains in the US.

The Bank of Canada's stance has not been too big of a driver for CAD lately, as the BoC does not stand out in the global easing cycle, mostly following in the Fed's footsteps in terms of pandemic measures (albeit in different magnitudes). As such – and as we expect Macklem to aim at a smooth transition from the Poloz era – this meeting is unlikely to change our view on CAD in the medium term.

Looking at the reaction on the day of the meeting, there is a risk of CAD having more sensitivity than the previous meetings even if no new policy measure is announced, as investors will be looking for any hint that Macklem's policy stance is different from the previous governor. However, we do not expect CAD's reaction to be very pronounced or long-lived.

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