Bank of Canada preview: Still no reason to turn dovish

We expect the Bank of Canada to reiterate its "accommodative" stance. Broadly positive data should offset lingering trade uncertainty so we think the chances for a dovish shift are limited, but so too is further upside for the Canadian dollar

Breaking down June's job report

Canada's payroll data, released at the same time as the US jobs report on Friday, showed a loss of 2.2k jobs in June. A closer look shows that this is entirely due to a slump in part time workers, with the full time reading actually quite positive at +24.1k.

See here our review of the Canadian jobs report

Release	Actual	Consensus	Prior
Net change in employment	-2.2k	9.9k	27.7k
Unemployment rate	5.5%	5.5%	5.4%
Hourly wage growth (perm. empl.) YoY	3.6%	2.7%	2.6%
Full time employment change	24.1		27.7
Part time employment change	-26.2		0.0

Source: Statistics Canada, ING

The unemployment rate ticked up (as expected) by 0.1% to 5.5%, though it continues to linger around historical lows. Conversely, wage growth boomed in June, touching 3.6% on a YoY basis. This suggests there are pipeline inflation pressures brewing at a time when inflation readings are already surprising on the upside.

All signs point to no change in monetary policy

Policy rates in Canada haven't been raised as aggressively as they have in the US over the past two years. So the BoC's repeated intention to keep policy "accommodative" should be read as "neutral". Such neutral rhetoric was justified in May's policy announcement by assessments about the current state of the Canadian economy as well as external drivers. We've looked at those factors and how they've changed since the 29 May meeting to identify the possible impact on the BoC's stance ahead of Wednesday's meeting.

Factor	May 29 language	Developments to-date	Impact on BoC stance
Labour market	"**strong** job growth suggests that businesses see the weakness in the past two quarters as temporary"	**Mixed signals** from the June jobs report, but robust full-time job growth still portrays a positive picture.	Neutral
Global economy	Trade conflicts "heightened **uncertainty**" but the "ratification of **CUSMA** will have **positive** implications"	US-China have **restarted trade talks** – although still far from a deal. Uncertainty remains. **CUSMA closer to ratification** by US congress.	Neutral
Inflation	Inflation "**in line**" with the Bank's projection. Core inflation is "close to 2 per cent".	**Inflation boomed** in the latest reading (May), with both headline and core measures largely above 2%. **Wage growth** sparked in June.	Hawkish
Oil outlook	The oil sector is beginning to **recover** as production increases and **prices** remain **above recent lows**.	Oil prices were broadly unchanged since the meeting but the outlook remains positive after **OPEC+ output cut deal**.	Neutral

Source: Bank of Canada, ING

The "wild card" remains the dovish stance of global central banks, with particular attention on the Federal Reserve. Although markets have partly pared back easing expectations for the Fed after an encouraging payrolls report last Friday, a 25 basis point rate cut at the 31 July meeting looks probable. We expect the Fed to follow up with a further 25bp rate cut in September so there will continue to be some in the market looking for the BoC to cut rates at some point, too. For the time being, the market is pricing in around 5bp of rate cuts before year-end with the OIS curve showing 19bp of expected easing by the BoC over the next 12 months.

CAD's reaction may be muted

In one of our recent publications ("Five reasons to stay long CAD") we highlighted how the long-term outlook for the Canadian dollar appeared positive and we expect a further leg lower in USD/CAD towards the end of 2019. Although we see little scope for a dovish surprise at this BoC meeting - which suggests limited upside risk in USD/CAD – we are reluctant to expect another sharp appreciation of CAD just yet. In fact, it seems that the rates and FX markets have already priced in most of the positives during the past week. The Canadian rate curve has shifted sharply to the upside, with the tenors between 2Y to 5Y leading the increase in yields. CAD has moved in tandem with yields, outperforming the USD for a third consecutive week despite a stronger dollar across the board. We expect a somewhat muted reaction of USD/CAD to the BoC meeting, which may only be tentatively positive for CAD.

With rates in Canada likely to stabilise after the central bank announcement, we expect the markets' attention to shift to the two major external drivers of CAD: oil prices and trade tensions. On the oil side, the much anticipated OPEC+ output cuts may have paved the way for a tighter oil market, but crude prices have actually been on the back foot in the past week. Being the highest correlated market factor to USD/CAD performance, we expect WTI price action to be the main driver of the pair in the coming weeks. Looking at the US-China trade conflict, our trade team remains quite sceptical that the current truce will lead to a deal anytime soon. We suspect that the US will eventually go ahead and lift tariffs on the remainder of Chinese exports, which would likely prompt a temporary rebound in USD/CAD towards 1.32 by the beginning of autumn. As trade tensions dissipate in 4Q19 and 1Q20, we expect CAD to resume its appreciation.

We expect the 10 July meeting to confirm the Bank of Canada's neutral stance on monetary policy, stressing a data-dependent approach. The BoC should continue to highlight the downside risks stemming from trade tensions and slowing global economic activity. Nonetheless, the data flow since the May meeting has been broadly positive, which tends to suggest a cautiously upbeat domestic economic assessment, while signalling little appetite for policy easing. This may be particularly true given the recent boom in inflation and wage growth which should prompt an upside revision in the CPI forecasts as the monetary policy report is published. In the aftermath of the meeting, the USD/CAD reaction may be broadly muted, as markets seem to have already priced in most of the positives for the loonie. We continue to expect policy rates to remain untouched over the next 18 months and believe that CAD will stay supported despite possibly facing kick-back from re-escalating trade tensions. Accordingly, we stick to our current USD/CAD forecasts at 1.30 for 4Q19 and 1.28 for 1Q20.

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