

Downside risk for CAD ahead of BoC meeting

The Bank of Canada meets on 22 January, and we expect no change in the monetary stance (in line with consensus). However, we suspect markets have too aggressively priced out BoC easing and the balance of risks for CAD appears tilted to the downside.

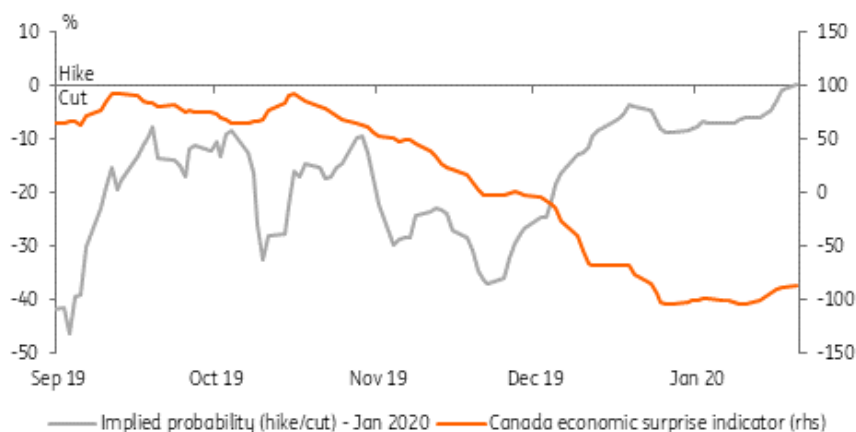


Rate expectations ignored bad data

The Bank of Canada will announce monetary policy on Wednesday 22 January and markets are widely expecting no changes in the policy rate. Investor sentiment around the prospect of BoC easing has shifted significantly in the past few months. The figure below shows the historical OIS-implied probability of a rate change at this January meeting: markets have sharply scaled down their easing expectations, starting from mid-November.

While this dynamic is in line with an improvement in the external backdrop (US-China trade talks and, eventually, the “Phase One” deal), markets have substantially ignored - if we only look at the OIS pricing - developments in domestic dataflow. In December the economic surprise indicator actually touched its lowest levels since 2009.

Easing expectations dropped, despite grim data



Source: Bloomberg, ING

MPR projections may be revised down

The slump in employment seen in the November jobs report – although partly recovered in December – was not the only stain on the Canadian economic outlook recently. GDP rose at a modest 1.3% in 3Q19 and fell in October, retail sales dropped, and housing activity slowed (building permits fell for six of the past ten months).

We suspect that a downward revision to the GDP forecasts published in the MPR on Wednesday (22 January) may be on the cards. With any significant change in the monetary policy stance unlikely for now, those projections have the potential to determine most of the market reaction.

CAD faces downside risk

Looking at the implication for CAD, the market's strong repricing of rate cut expectations puts the bar for a hawkish surprise very high. The BoC has made the strong economic backdrop the basis of its reluctance to follow the global easing trend and investors' unwillingness to embed poor data into their rate expectations leads us to believe there is a mis-pricing of rate cut probabilities (only 22% for a 1H move) in the next few months.

In turn, we believe the balance of risks for the loonie is tilted to the downside ahead of Wednesday's rate announcement and that a downward revision in the Bank's GDP forecasts may prompt markets to bring forward their cut expectations. We continue to have a constructive view on CAD in the longer term and a one-off cut in the next few months would not dent such an advantage. However, our view on the BoC makes us believe USD/CAD will struggle to consistently trade below 1.30 in the near term, also on the back of an uninspiring oil outlook.

Author

Francesco Pesole

FX Strategist

francesco.pesole@ing.com

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies).* The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit <http://www.ing.com>.