

Bank of Canada: Locking down rates for longer

The BoC has left rates unchanged and signaled little prospect of a hike until 2023. It is also focusing asset purchases at the long end of the curve in the hope that a flatter, lower yield curve will deliver support that the economy needs



Source: Shutterstock

Looser for less

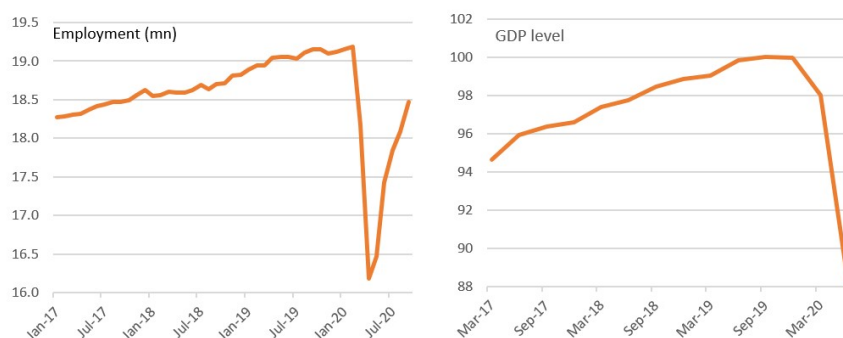
The Bank of Canada left the policy rate unchanged at 0.25% at today's meeting, but has "recalibrated" its quantitative easing programme by shifting its purchases towards the longer end of the yield curve. Given household and corporate borrowing costs tend to be more influenced by longer-term government borrowing costs, focusing spending here and flattening the yield curve, they believe, gives them more bang for their buck.

The BoC have consequently lowered the total asset purchases from "at least C\$5bn" a week to "at least" C\$4bn per week. In their view this will not lead to any tightening of monetary conditions.

Growth constrained

With regard to the economy they note that the recovery through 3Q20 has been stronger than they anticipated, but acknowledge global activity has slowed in the fourth quarter and that “rising COVID-19 infections are likely to weigh on the economic outlook”. Canada is not going to be immune with the BoC anticipating that growth will slow “markedly” and noting that the impact is highly uneven across the economy with low-income workers particularly impacted.

Canadian employment and GDP levels



Source: Macrobond, ING

Lower for longer

Even with 4% average growth expected through 2021 and 2022, Canada's large output gap means that inflation will “remain below target throughout the projection horizon”. With the pandemic set to have “long-lasting effects” the economy will “continue to require extraordinary monetary policy support” for some time to come.

Consequently the BoC's forward guidance has shifted to state that policy won't be normalised until the 2% inflation target is “sustainably achieved”, which under their current forecasts won't happen until 2023. So, like the Federal Reserve, the Bank of Canada is putting its money where its mouth is and confirming that lower for longer is the new norm.

No game changer for CAD

Markets were likely expecting a policy message that would have the "lower-for-longer" pledge at the centre, and the announcement only added some marginal pressure to the Canadian dollar in a very grim day for pro-cyclical currencies.

In the longer term, the prospect of rates locked at the lower bound is hardly a game changer for CAD as the BoC does not particularly stand out as a dovish outlier in the G10 ultra-accomodative environment. Actually, the BoC remains the least dovish central bank in the G10 \$-bloc considering both the Reserve Bank of Australia and the Reserve Bank of New Zealand appear set to add more stimulus soon.

The announcement that bond purchases will be scaled down should bode well for the BoC-Fed relative balance sheet (also considering the significant firepower still at the Fed's disposal), which rose dramatically as the BoC started QE but had already flattened up in the past couple of months. This may ultimately prove beneficial for a benign USD/CAD decline in coming months. We maintain our 4Q20 target at 1.30 for USD/CAD.

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