Canada: BoC delivers 50bp cut

The Bank of Canada has followed in the footsteps of the Fed and cut the overnight lending rate by 50bp. It may support sentiment temporarily, but it will do little to offset the fear-driven economic damage from Covid-19

Bank of Canada Governor Stephen Poloz

50bp with more cuts to come

Following yesterday's decision from the Federal Reserve to cut rates 50bp, there was intensifying pressure on the Bank of Canada to follow suit and that is what they have done - lowering the overnight rate to 1.25%. The accompanying press release justifies the action on the basis that Covid-19 provides a "material negative shock". Growth "will be weaker than the Bank had expected" and the BoC "stands ready to adjust monetary policy further if required".

The economic picture was darkening in any case

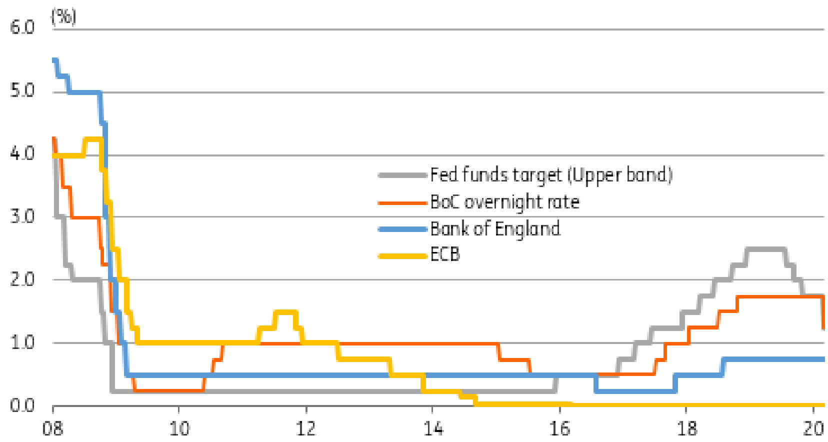
In any case, the economic outlook had been weakening even before coronavirus fears started to take hold within Canada. GDP growth had slowed to just 0.3% annualised in 4Q19 and it seems probable that 1Q20 Canadian activity was going to be depressed by supply chain disruption because of factory closures in China and other parts of Asia. Exports will also have been hurt by weaker demand from the Asia region while protests trying to block the construction of the Coastal GasLink pipeline have had a disruptive effect on rail, road and sea transportation.

As elsewhere, the plunge in equities and bond yields means the economy is also facing a financial shock that could lead to economically disruptive strains in lending markets. Then there is the threat of an aggregate demand shock as a sense of fear leads to consumers and businesses changing their behaviour. This is most likely going to be felt in the services sector with travel, leisure and personal services sectors looking vulnerable to a sharp drop in demand. Add in the plunge in commodity prices, most notably oil, and business investment will likely weaken. An outright contraction in economic activity is a distinct possibility for 2Q20.

More to come from the BoC

The Bank of Canada has a reputation of being prepared to move early and deliver occasional surprise moves. We believe today's action is the start of a series of rate cuts. Moreover, even after today's move the BoC has more room than most central banks to provide support to the economy and financial markets (see chart below).

BoC has the room to offer more stimulus



Source: Macrobond, ING

As with yesterday's Federal Reserve's rate cut, today's BoC move may help to head off some potential strains in the financial system and lift sentiment temporarily, but it will do little to prevent a drop in aggregate demand. Fiscal policy would likely deliver more meaningful support, but we are not expecting swift action on that front. So, with the domestic newsflow surrounding Covid-19 likely to get worse before it gets better, the BoC will be forced to keep doing what it is doing - we expect a further 50bp of rate cuts in coming months.

Author

James Knightley
Chief International Economist, US
james.knightley@ing.com

Disclaimer