Bank of Canada plays the long game

While noting signs of improvement, the Bank of Canada has emphasised that policy will remain ultra-accommodative for a number of years. This means short rates pinned to the floor and longer-dated yields staying depressed. This suggests the central bank will play second fiddle to other short-term drivers of CAD: global sentiment, oil and US covid cases

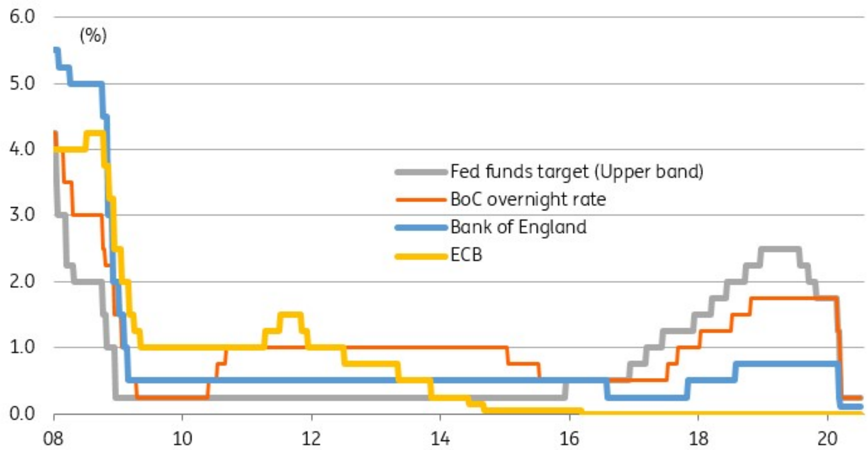
Source: Shutterstock

0.25% Bank Rate and C$5bn of weekly bond purchases to continue

The Bank of Canada, with new Governor Tiff Macklem at the helm, has left monetary policy unchanged. Bank rate has been held at "the effective lower bound of 0.25%" with the purchases of "at least C$5bn per week" of government bonds continuing. All other liquidity programmes plus the provincial and corporate bond purchase programmes will continue with the bank pleased by the fact that they "continue to improve market functioning", noting that "with reduced market strains, their use has declined".

The press release underlines the sense of uncertainty with the central bank presenting a central scenario based on there being no second Covid wave. This concludes that the most likely outcome is a 5% contraction in the global economy over the course of 2020 before rebounding 5% in both 2021 and 2022 with the risks tilted to the downside given the potential for a resurgence in infections.

Central Bank policy rates



Source: Macrobond, ING

A long road to recovery

Canada is looking for a decline in output of 7.8% this year with growth of 5.1% next year and 3.7% in 2022 (ING is forecasting -7.1%, +4.6% and +2.8% for the respective years). The reason for Canada's under-performance we would put down to its greater dependency on commodities, particularly oil and gas, which are experiencing major structural challenges. It is also more exposed to international trade versus many other major economies, which with rising protectionism and uneven country recoveries poses challenges.

As such a significant output gap will remain in existence for a number of years, which will depress medium-term price pressures. Consequently, inflation is not a constraint to Bank of Canada policy and the press conference states that even as the recovery continues the economy will require ongoing "extraordinary monetary policy support".

Bank Rate set to stay at 0.25% through at least the end of 2022

More specifically the BoC state that rates will be held at 0.25% "until economic slack is absorbed so that the 2 percent inflation target is sustainably achieved". They will also seek to keep a lid on longer dated yields, implying no let up anytime soon in their bond buying programmes. We continue to expect Bank Rate to be held at 0.25% through at least the end of 2022.

CAD: BoC is not a driver now

The loonie showed a contained reaction right after the BoC announcement, and the following move lower in USD/CAD was partly related to a rebound in oil. The content of Tiff Macklem's first meeting matched what was already priced into the Canadian dollar: rates at the bottom for longer, openness to more stimulus if needed, no additional QE for now. Incidentally, the policy announcement has reiterated the notion that the BoC does not stand out as a dovish/hawkish outlier in the generalized ultra-loose global monetary environment. This keeps us reluctant to factor in the BoC's stance as a key driver in the CAD outlook for the coming months.

For now, global sentiment remains inevitably the key driver, although it must be noted that CAD has been unable to fully cash in on recent risk-on runs. One of the reasons is, in our view, the high exposure of the Canadian economy to fresh lockdown measures in the US, which may well continue to keep a lid on CAD in the short-term.

Looking at the oil prospects, the news that OPEC+ is set to unwind some of the cuts starting from August had already been largely priced in and is failing to significantly pressure oil prices. We remain positive on the oil prospects for the rest of the year and expect them to play a supportive role for CAD.

Author

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

Francesco Pesole
FX Strategist
francesco.pesole@ing.com