MNI Bank Of Canada Preview: Mar 2023

Meeting: Wed, 8 March
Statement only: 1000ET

Economic Progress Report, w/ Senior Dep Gov Rogers: Thu, 9 Mar. Remarks 1330ET, starting 1345ET

MNI Review of Jan Meeting: https://marketnews.com/mni-boc-review-jan-23-gearing-up-for-a-potentially-lengthy-pause

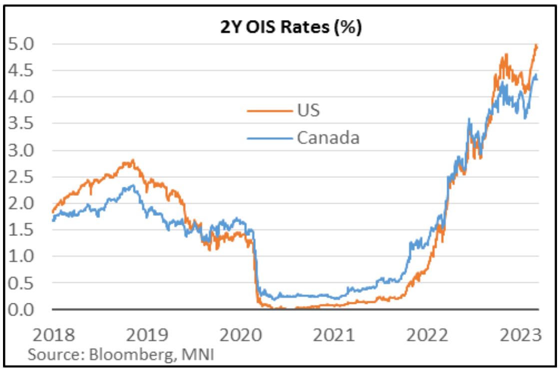
Contents

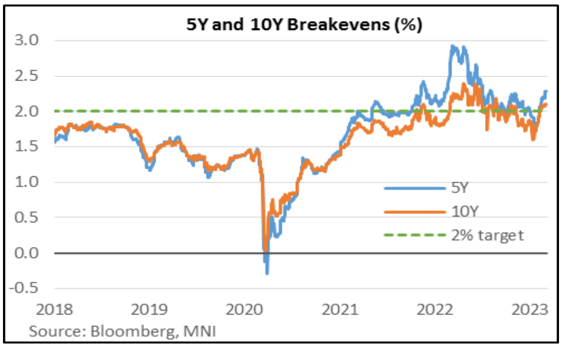
MNI POV (Point Of View): Maintaining The Conditional Pause

By Chris Harrison

- The BoC is unanimously expected to keep rates on hold at 4.5% on Wednesday and for the most part echo January's pivot to guidance of a conditional pause whilst leaving the door open to further hikes.
- Data has been mixed. Employment was far stronger than expected but CPI showed some moderation and GDP was surprisingly soft, albeit partly offset by hawkish implications from weaker productivity growth.
- Surprises should never be ruled out from the BoC, with a weaker CAD adding inflationary pressure at the margin. However, market reaction could be limited with focus on nuances of the single page statement before potentially more detail in Thursday's Economic Progress Report from Senior Dep Gov Rogers.

The Bank of Canada (BoC) is unanimously expected to leave its policy rate unchanged at 4.5% on Wednesday, having hiked 425bps over the past year, 275bps of which since July. The January decision to hike a potentially final 25bp came with a conditional pause if economic developments are broadly as expected whilst explicitly leaving the door open to further hikes if needed, although guidance from the press conference, reiterated in the first ever minutes, was that the BoC is looking for an accumulation of evidence for the need for further hikes.





Fed rate expectations have soared on stronger data in the US but Canadian data have been more mixed and don't change the BoC's recent narrative (and with Dep Gov Beaudry noting an openness to different rate paths to its counterparts). Yes, the labour report came in far stronger than expected but the data can be noisy, whilst some monthly measures of core CPI inflation showed decent progress and GDP growth was weaker than both the market the BoC expected in Q4. The cleanest option for Wednesday's meeting is to broadly repeat this conditional pause guidance whilst leaving open the door to further hikes, in largely a stepping stone for the April decision and its Monetary Policy Report. This door remaining open is important considering the push higher in inflation expectations despite rates climbing. We feel market reaction will be most susceptible to how high the bar is to further hikes, which could hinge on language concerning the labour market plus the latest inflation trends. This in turn could help shape market reaction to upcoming releases with two labour reports, one CPI report and the quarterly BoC surveys before the April decision and its fresh forecasts.

What To Watch In The Statement

The concluding paragraph might be tweaked but we don't expect a material change in the message of a conditional pause with the door open to further hikes. "With persistent excess demand putting continued upward pressure on many prices, Governing Council decided to increase the policy interest rate by a further 25 basis points. The Bank's ongoing program of quantitative tightening is complementing the restrictive stance of the policy rate. If economic developments evolve broadly in line with the MPR outlook, Governing Council expects to hold the policy rate at its current level while it assesses the impact of the cumulative interest rate increases. Governing Council is prepared to increase the policy rate further if needed to return inflation to the 2% target, and remains resolute in its commitment to restoring price stability for Canadians. " A hawkish option could be greater openness to hikes whilst one marginally dovish surprise could be mention of the need to see an accumulation of evidence as to whether further hikes are needed. The latter would merely reiterate what was said in the press conference and commentary since then, but formal inclusion could catch some attention. Macklem has since referred specifically to inflation deviations from projections as to guiding the need for further hikes although we see this focus as not particularly surprising considering the lack of a formal dual mandate. The cleanest option is to leave existing guidance little changed.

Language on the labour market was one of the few areas of the January statement that was as hawkish, if not more so, than December. "Labour markets are still tight: the unemployment rate is near historic lows and businesses are reporting ongoing difficulty finding workers." Any further focus plus concerns around difficultly finding workers would be notable, especially as vacancies from the SEPH report have shown a solid rolling over.

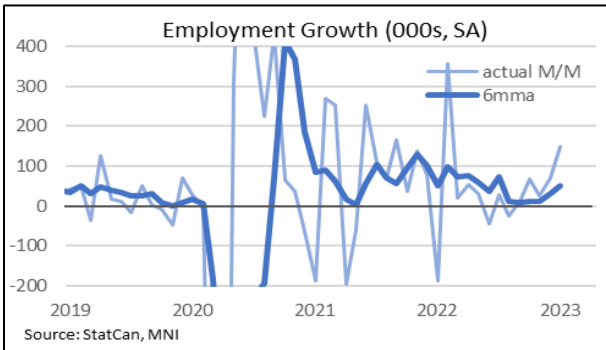
Inflation language was succinct in January: "3-month measures of core inflation have come down, suggesting that core inflation has peaked. Short-term inflation expectations remain elevated." The recent rise in inflation expectations opens the possibility of a hawkish surprise re inflation expectations, with scope for re-inclusion of something similar to "the longer short-term expectations remain elevated the greater the risk high inflation becomes entrenched" from prior statements but dropped in January. Otherwise watch the latest take on core CPI trends. Finally, we watch for updates on the latest perceptions of excess demand and the process of softer growth allowing supply to catch up, as well as any changes on housing activity, deemed to have "declined substantially" in Jan.

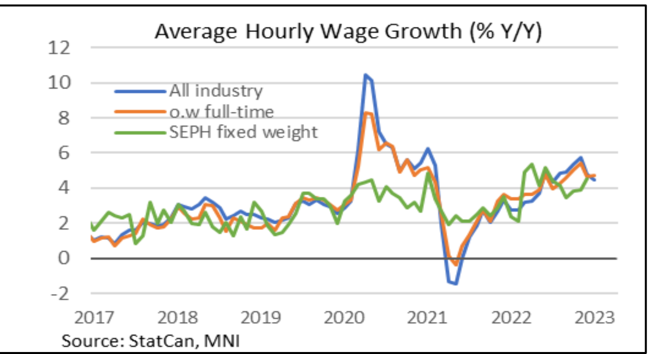
Major Macro Developments Since Jan 25 Decision

Labour market: Surprise Jobs Surge Pushes U/E Rate Back Near Series Lows

Annual revisions released after the Jan 25 decision had shown notably softer employment and wage growth than first thought in 4Q22, but this was more than offset by a far stronger than expected labour report for January a few days later. Jobs increased by 150k (cons 15k) after last month's downward revised 69k and were primarily driven by full-time positions (+121k). That concentration in full-time positions plus sickness-related absenteeism closer to seasonal norms helped see hours worked rise 0.8% M/M, the strongest since May. Contrary to tepid real GDP growth in 2H22 and an economy expected to see little growth in 1H23, the six-month average of 50k is the highest since July in a surprise upturn from the ~10k of the fall. An equally large jump in the labour force meant that the u/e rate was unchanged, although at 5.0% it was a tenth lower than the 5.1% expected and is just 0.1pp off series lows of 4.9% from the summer. This was more impressive considering the participation rate increased 0.3pps to 65.7% back to where it had been in late 21/1H22 and at least pushing back closer to pre-pandemic levels.

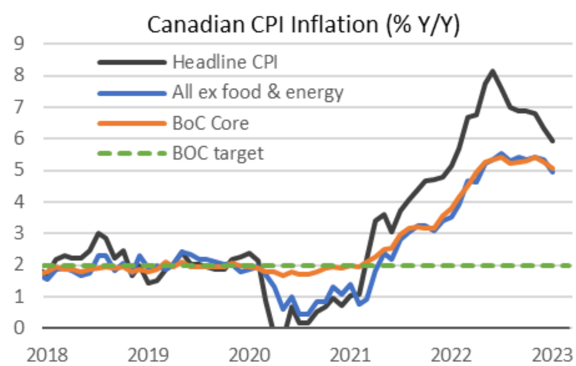
There were, as ever, caveats, including the volatility of the jobs figures and their proneness to sizeable revisions. Annual wage growth meanwhile continued to edge lower from a downward revised 4.8% to 4.5% Y/Y (from a Nov peak of 5.8%). Wage growth for full-time positions was stickier at 4.7% Y/Y (but still down from a Nov peak of 5.5%). Both are clearly still elevated but do at least show signs of moderation, something keenly watched for.



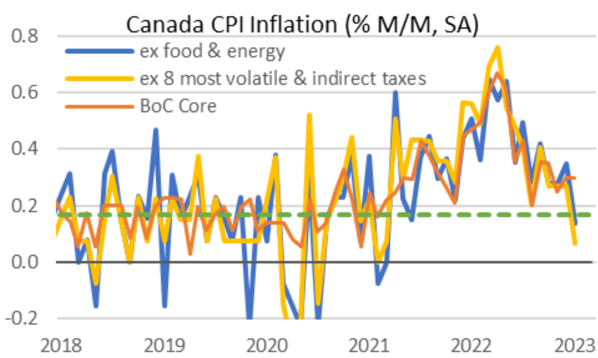


CPI inflation: Headline Softer Than Expected, Core Moderation More Broadly In Line
The single CPI report for January saw headline inflation ease by more than expected, from 6.3% to 5.9% Y/Y (cons 6.1%). It follows an average 6.7% in Q4 and took a solid step to the 5.4% the Bank expects it to average in Q1. Core inflation rates were closer to expectations with the average of the median and trim measures as expected at 5.05% Y/Y. This did however mark a slightly faster moderation as December was revised up to a joint cycle high of 5.25% Y/Y. This easing in Y/Y inflation after months of little progress is something mirrored in a more traditional measure of headline ex food & energy, cooling from 5.34% to 4.95% Y/Y for its lowest since April.

Monthly rates of core inflation showed a somewhat more mixed picture. Traditional measures of ex food & energy and ex 8 most volatile and indirect taxes showed renewed progress, falling below a rate consistent with the 2% target for the first time since Jun'21 and Mar'21 respectively (0.14% & 0.07% M/M). The average of the median and trim meanwhile held steady at 0.3% M/M for the third month running (the latter formally published via indexes for the first time in a further improvement for transparency after the introduction of the minutes at the last BoC decision). The January statement noted that "3-month measures of core inflation have come down, suggesting that core inflation has peaked" remains true but there has been little new progress here, at least if focusing on the median & trim measures.

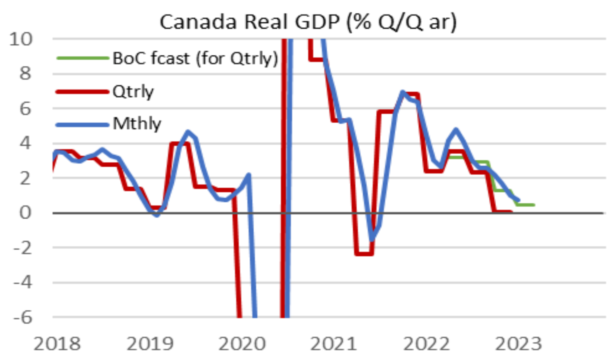


Source: MNI, StatCan. BoC core using average of trim & median

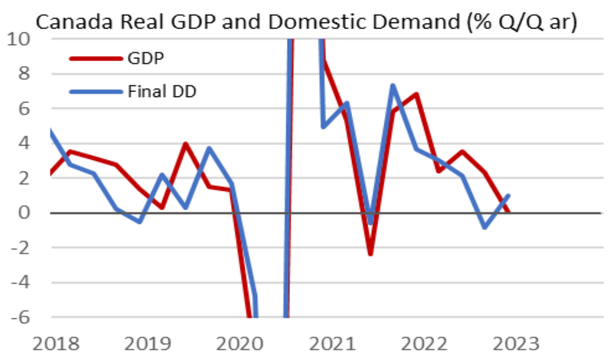


Source: MNI, StatCan BoC core using average of trim & median

GDP growth: Clearly Weaker Than Expected GDP, With Productivity Also Disappointing
GDP growth came in notably softer than expected in Q4 at 0.0% (cons 1.6) after a downward revised 2.3% annualized in Q3. Whilst also softer than the BoC had forecast (1.3% as of the January MPR, itself revised up from 0.5% in the October publication), it's still consistent with language of expectations that growth will stall through mid-2023 with chances of a small decline or small increase. The separate monthly data showed a tentative 0.3% M/M bounce in the January advance release although the Q4 print was a timely reminder in the differences between the two - monthly GDP increased 1% annualized in Q4. Final domestic demand, having provided a decent one quarter lead on GDP through 2022, bounced from -0.8% to +1% in Q4 but in doing so has largely stalled. We don't expect the BoC to put much weight on this domestic demand bounce, in the flip side of not doing so when it came to hiking 50bp back in December after the Q3 weakness. Overall GDP growth presents a clear enough picture: growth has stalled despite a revival in employment growth late in the year, after prior relative resilience of growth was one factor that tipped the BoC to hiking 25bps vs keeping on hold back in January. However, weaker labor productivity at just -0.5% in Q4 after a downward revised -0.3% in Q3 (initial +0.6%), opens a potentially hawkish angle after Governor Macklem specifically noted a focus on productivity in inter-meeting remarks.



Source: StatCan, MNI



Source: StatCan, MNI

Jan 25 Statement

(This month's to be shorter being a non-MPR meeting)

The Bank of Canada today increased its target for the overnight rate to 4½%, with the Bank Rate at 4¾% and the deposit rate at 4½%. The Bank is also continuing its policy of quantitative tightening.

Global inflation remains high and broad-based. Inflation is coming down in many countries, largely reflecting lower energy prices as well as improvements in global supply chains. In the United States and Europe, economies are slowing but proving more resilient than was expected at the time of the Bank's October *Monetary Policy Report* (MPR). China's abrupt lifting of COVID-19 restrictions has prompted an upward revision to the growth forecast for China and poses an upside risk to commodity prices. Russia's war on Ukraine remains a significant source of uncertainty. Financial conditions remain restrictive but have eased since October, and the Canadian dollar has been relatively stable against the US dollar.

The Bank estimates the global economy grew by about 3½% in 2022, and will slow to about 2% in 2023 and 2½% in 2024. This projection is slightly higher than October's.

In Canada, recent economic growth has been stronger than expected and the economy remains in excess demand. Labour markets are still tight: the unemployment rate is near historic lows and businesses are reporting ongoing difficulty finding workers. However, there is growing evidence that restrictive monetary policy is slowing activity, especially household spending. Consumption growth has moderated from the first half of 2022 and housing market activity has declined substantially. As the effects of interest rate increases continue to work through the economy, spending on consumer services and business investment are expected to slow. Meanwhile, weaker foreign demand will likely weigh on exports. This overall slowdown in activity will allow supply to catch up with demand.

The Bank estimates Canada's economy grew by 3.6% in 2022, slightly stronger than was projected in October. Growth is expected to stall through the middle of 2023, picking up later in the year. The Bank expects GDP growth of about 1% in 2023 and about 2% in 2024, little changed from the October outlook.

Inflation has declined from 8.1% in June to 6.3% in December, reflecting lower gasoline prices and, more recently, moderating prices for durable goods. Despite this progress, Canadians are still feeling the hardship of high inflation in their essential household expenses, with persistent price increases for food and shelter. Short-term inflation expectations remain elevated. Year-over-year measures of core inflation are still around 5%, but 3-month measures of core inflation have come down, suggesting that core inflation has peaked.

Inflation is projected to come down significantly this year. Lower energy prices, improvements in global supply conditions, and the effects of higher interest rates on demand are expected to bring CPI inflation down to around 3% in the middle of this year and back to the 2% target in 2024.

With persistent excess demand putting continued upward pressure on many prices, Governing Council decided to increase the policy interest rate by a further 25 basis points. The Bank's ongoing program of quantitative tightening is complementing the restrictive stance of the policy rate. If economic developments evolve broadly in line with the MPR outlook, Governing Council expects to hold the policy rate at its current level while it assesses the impact of the cumulative interest rate increases. Governing Council is prepared to increase the policy rate further if needed to return inflation to the 2% target, and remains resolute in its commitment to restoring price stability for Canadians.

Central Bank Watch - Bank of Canada

March 06, 2023

MNI Bank of Canada Data Watch List

Inflation		Current	3m ago	3m Chg	6m ago	6m Chg	2Y History	Hit / Miss	Vs Trend	Surprise Index	Z-Score
CPI	% y/y	5.9	6.9	↓	7.6	↓					0.32
Core CPI - Median	% y/y	5.0	5.2	↓	5.2	↓					-1.30
Industrial Product Price	% m/m	0.4	2.2	↓	-2.4	↑					0.62
Breakeven 10-Year	%	2.10	1.86	↑	2.02	↑					1.19
Economic Activity		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
PMI Manufacturing	Index	52.4	49.6	↑	48.7	↑					-0.67
GDP	% m/m	-0.1	0.2	↓	0.3	↓					-2.09
Manufacturing Sales	% m/m	-1.51	-0.16	↓	-0.16	↓					-0.91
Trade Balance	CAD bn	-0.16	0.87	↓	3.32	↓					-0.83
Monetary Analysis		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
M3 Money Supply	% y/y	8.11	8.33	↓	9.18	↓					0.15
Bank Lending Survey (Q)	% m/m	4.07	0.57	↑	-0.64	↑					1.43
New House Prices	% m/m	-0.2	-0.2	→	0.1	↓					-1.02
Housing Starts	K	215.4	263.7	↓	277.6	↓					-2.00
Consumer / Labour Market		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
Retail Sales	% m/m	0.5	-0.6	↑	0.7	↓					0.18
Retail sales Ex-Autos	% m/m	-0.6	-0.9	↑	0.3	↓					-0.39
Employment Chge m/m	K	150.0	68.3	↑	28.3	↑					1.87
Ave Hourly Wage Rate	% y/y	4.46	5.21	↓	4.38	↑					-1.16
Markets		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
S&P/TSX Composite	Index	20539	20453	↑	19331	↑					0.07
Canadian 10-Year Yield	%	3.36	2.94	↑	3.12	↑					1.02
CAD Yield Curve (2s-10s)	bps	-89.6	-93.7	↑	-53.3	↓					-0.93
CAD TWI	Index	117.98	120.13	↓	123.35	↓					-0.89

Note: For quarterly data the 3m ago column will display the previous data point and the 6m ago column will display the data point prior to that.
Source: MNI, Bloomberg

Key Inter-Meeting BoC Commentary

Speaker	Commentary Since Previous BoC Rate Decision
Tiff Macklem (Governor)	Monetary Policy At Work (Feb 7) <u>Focus on inflation</u>: “If new evidence begins to accumulate that **inflation is not declining in line with our forecast**, we are prepared to raise our policy rate further. But if new data are broadly in line with our forecast and inflation comes down as predicted, then we won’t need to raise rates further.” <u>Pausing to avoid slowing economy too much</u>: “Typically we don’t see the full effects of changes in our overnight rate for 18 to 24 months. That’s why policy needs to be forward looking. In other words, we shouldn’t keep raising rates until inflation is back to 2%. Instead, **we need to pause rate hikes before we slow the economy and inflation too much**. And that is what we are doing now.” <u>Watching productivity, labour costs and service inflation closely</u>: “Wage growth is currently running between 4% and 5% and appears to have plateaued within that range. With our survey of businesses also suggesting that inflation expectations are edging back, the risk of a wage-price spiral has diminished. **Still, wage growth in that range is not consistent with getting inflation back to the 2% target unless productivity growth is surprisingly strong. We will be watching productivity, labour costs and services price inflation closely**.” <u>Balanced risks to inflation outlook</u>: “There are risks to our projection. The biggest is that global energy prices could increase, pushing inflation up around the world. We’re also concerned that inflation expectations could remain elevated and increases in labour costs could persist. If these upside risks materialize, we are prepared to raise interest rates further to return inflation to the 2% target.” “There are downside risks to our projection as well. Global growth could slow more sharply than we expect, and financial vulnerabilities could amplify the slowdown. Canadian households could pull back more than we expect as they adjust to higher interest rates.”
Paul Beaudry (Dep Gov)	Our Commitment To 2% Inflation (Feb 16) "The bottom line is that we shouldn’t be too concerned if Canada follows a slightly different path to normalization than our counterparts. What matters most is getting all the way there.”

MNI Instant Answers

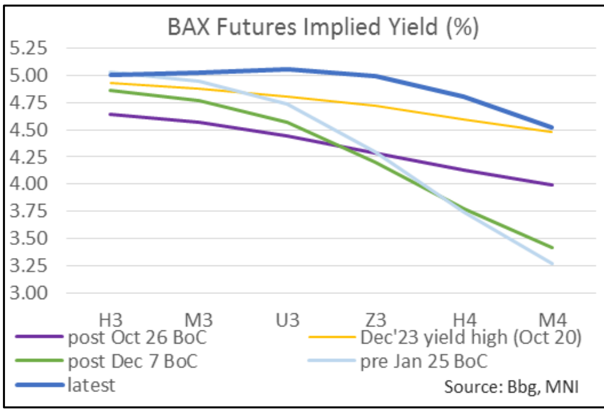
The questions that we have selected for this meeting are:

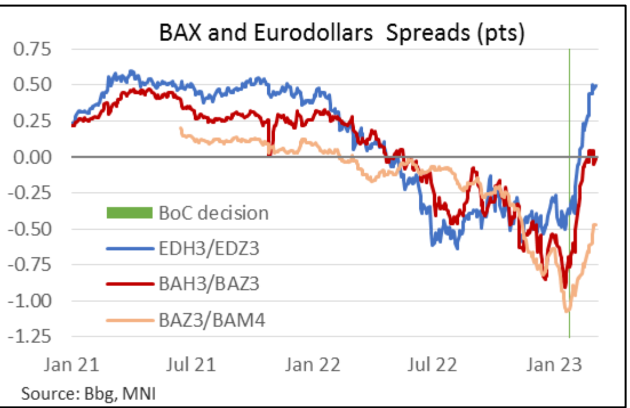
- Overnight Rate Target (level)
- Does the Bank reiterate it expects to hold rates at the current level if the economy evolves about as expected?
- Does the Bank reiterate it's prepared to raise interest rates further if needed to return inflation to the 2% target?
- Does the Bank of Canada say it will likely need to raise interest rates?
- Does the Bank remove the phrase saying that it will likely keep interest rates on hold?
- Does the Bank signal it could lower interest rates?

Markets Heading Into The Decision

Substantial Higher For Longer Push In FI

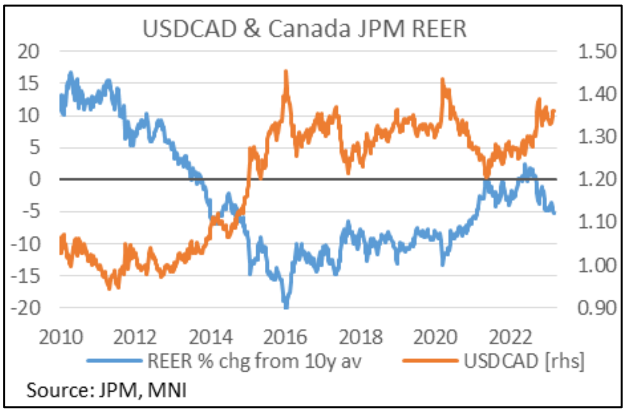
Unsurprising considering the nature of a conditional pause and mixed data, near-term rate expectations are little changed compared to after the Jan 25 decision. That hides some major changes further out the curve though, with the global theme of higher rates for longer in full swing, led by US data. OIS crudely shows half a 25bp hike priced through the year with no cuts for 2023, consistent with a substantial pivot in BAX futures with the BAH3/Z3 time spread fully unwinding three cuts that had been priced for 2023. Further large increases in 1H24 implied yields see the Jun'24 yield 125bps higher.





USDCAD Consolidates Push Higher, C$ 5% Lower Real Effective Average

USDCAD has pushed 1.7% higher since the last decision to hover around 1.36, which could draw some reaction from the BoC. It does however remain off levels of 1.39 that saw more explicit focus at the October decision. Looking at longer-term trends, the Canadian dollar has pushed to 5% below its 10-year real effective average, touching the lowest on that basis since Jan'21.



Summary of Analyst Views

- The Bloomberg analyst survey published Feb 22 (most likely collected prior to CPI on Feb 21 and clearly before softer GDP on Feb 28) showed no analyst expected a rate change over the next three meetings.
- UBS stood out with a far more dovish forecast, eyeing 2.5% rates by year-end and 0.25% in next March.
- Some of these analyst rate calls might have changed further out but near-term they remain consistent with the twelve summarised previews below.

Bloomberg analyst survey of policy rate forecasts published Feb 22:

	Mar. 8 2023	Apr. 12 2023	Jun. 7 2023	Jul. 12 2023	Sep. 6 2023	Oct. 25 2023	Dec. 6 2023	Jan. 2024	Mar. 2024	May 2024
Median	**4.50%**	**4.50%**	**4.50%**	**4.50%**	**4.50%**	**4.50%**	**4.50%**	**4.00%**	**4.00%**	**3.75%**
Barclays	4.50%	4.50%	4.50%	4.50%	4.50%	n/a	n/a	n/a	n/a	n/a
BMO	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	n/a	n/a	n/a
Capital Econ.	4.50%	4.50%	4.50%	n/a	n/a	n/a	n/a	n/a	n/a	n/a
CIBC	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.25%	4.00%	3.75%
Alberta Central	4.50%	4.50%	4.50%	4.50%	4.50%	4.25%	4.25%	4.00%	4.00%	3.75%
Desjardins	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.25%	n/a	n/a	n/a
Goldman Sachs	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	n/a	n/a	n/a
ING	4.50%	4.50%	4.50%	n/a	n/a	n/a	n/a	n/a	n/a	n/a
JPM	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	n/a	n/a	n/a
Krungthai Bank	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.25%	4.00%	3.75%	3.50%
Oxford Econ.	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.00%	4.00%	3.50%
PNC	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.25%	4.00%	3.75%
RBC	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	n/a	n/a	n/a
Scotiabank	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.25%	4.25%	3.75%	3.75%
TD Economics	4.50%	4.50%	4.50%	4.50%	4.50%	n/a	n/a	n/a	n/a	n/a
TD Securities	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	n/a	n/a	n/a
UBS	4.50%	4.50%	4.50%	4.00%	3.50%	3.00%	2.50%	1.50%	0.25%	0.25%

Red denotes rate cut

Source: Bloomberg survey through Feb 14-21, MNI

Analysts' Key Comments

(In alphabetical order):

BofA: No Change Expected

- We expect the BoC keep on hold its overnight rate target at 4.50%.
- The labor market remains tight, but inflation has softened in recent months, mostly due to gasoline prices, and the softening of the economy is in line with what the BoC expects.

CBA: Data Supports Case For Pause

- At its 26 January policy meeting, the BoC explicitly communicated its intent to hold the policy rate at the current level while assessing the impact of the cumulative tightening delivered to date.
- The weaker than expected economic growth in 4Q22, combined with lower underlying inflation, supports the case for a pause in the tightening cycle.

CIBC: Sticking With A Hawkish But Made-In-Canada Pause

- Having pledged to pause on rate hikes to see how things unfold, Governor Macklem has little choice but to keep Canada's policy rate unchanged when the Bank of Canada meets in the week ahead.
- Yes, there were conditions applied to that pause and warnings that hikes might resume, but only if there were evidence that the economy was diverging from the Bank's forecast. A month or so of data can hardly be deemed to be sufficient to reach such a conclusion.

- Still, the market isn't at this point convinced that this will be a lasting pause, and the Governor has shared his own doubts. In part, that's a reaction to the upside surprise we saw in January's employment data, which along with a rebound in GDP for that month, points to a renewal of growth to start the year. That said, while Q1 growth is likely to top the last BoC forecast, that won't fully offset the downside surprise registered in Q4 data released this past week, and inflation also came in below expectations.
- No doubt, the Bank of Canada, while leaving rates on hold in the week ahead, will want to remind investors that the pause is still conditional on seeing the economy track in line with its last forecast. This is still a hawkish pause, in effect. But it's also a made-in-Canada pause that will be less influenced by the Fed than many think.

Citi: Expecting No Change With Chance Errs Somewhat More Clearly On Keeping Further Hikes Open

- Very likely that rates will remain unchanged given that economic developments have evolved "broadly in line with the MPR outlook".
- Any hawkish or dovish outcome will thus be a result of the updated policy statement. We expect a mostly neutral tone to Wednesday's statement, although with slightly hawkish risks as it is very likely that the BoC sees a greater chance of having to hike again now than when they signaled a pause in January.
- The statement should acknowledge softer than expected GDP growth but note this is consistent with activity moving largely sideways as intended.
- We expect the statement to still characterize the economy as being "in excess demand", although there could be some dovish adjustments, such as an addition that excess demand is moderating. However, there could be hawkish additions to the statement as well, such as noting that the 3-month measures of core inflation, while softer, are still running above the 2% target.
- The EPR speech by Senior Dep Gov Rogers could give some more insight into how the BoC perceives the balance of risks for policy over the coming months, which is likely more on the upside than in January.
- We still expect that the current global backdrop of higher inflation and higher rates than at the time of the January BoC meeting should mean the BoC errs somewhat more clearly on the side of keeping the option of further rate hikes open.

Desjardins: Little Change Whilst Leaving The Door Open To Further Hikes

- Expect the BoC to keep rates steady next week. It announced in Jan that it wouldn't raise interest rates any further if the economy and inflation evolved in line with its projections, and economic data since then have been mixed.
- A robust labour market coupled with a reacceleration of inflation south of the border has raised the spectre of further rate hikes down the road. But with recent growth figures showing the economy stalling in Q4 and inflation data slowing early this year, the Bank can be comfortable knowing there are credible signs its monetary policy medicine is working its way through the economy.
- That said, given how many times the central bank has been burned by bad forecasts recently, the statement accompanying the rate decision will still leave the door open to further increases should the economy veer off its intended path.

GS: Not Expecting Any Significant Changes With Focus On Labor Market

- We expect the BoC to follow through with its guidance to be on hold this week, along with no change in forward guidance and other changes to be relatively limited and to mostly reflect language from recent BoC communication.
- In the statement and press conference, we will be focused on any comments on the labor market, since employment growth remains very strong but labor supply is improving and sequential wage growth is moderating.
- We maintain our forecast that moderating inflation and improving labor market balance will keep the BoC on hold past March.
- While we continue to see meaningful risk that the BoC will resume hikes later this year if growth materially picks up or inflation surprises to the upside, we see limited risk of a hike at the next meeting in April given that there is only one more inflation print before then.

ING: On Hold With Door Still Open To Further Hikes If Necessary, But Expect Cuts Later

- The data since the Jan 26 conditional pause has shown inflation undershooting expectations despite remaining well above the 2% target and GDP growth stalling at 0%, significantly below the 1.6% expected. However, the economy continues to create jobs in significant numbers.

- The weak growth and disinflation story should trump the jobs data especially given that monetary policy operates with long and varied lags and labour market data tends to be the most lagging of all.
- Canada is more exposed to the risk of a housing market correction than in the US and we look for the economy to contract later this year, with a strong chance that the BoC will cut rates later in the year.
- The fact that the BoC has paused (and mostly likely peaked) naturally has negative implications for CAD: a wider USD-CAD rate differential reduces USD/CAD downside potential although by stopping rather than continuing to hike it limits a build-up of housing-related risk premium. In other words, the BoC pause means both fewer upside and downside risks for the loonie.
- There are very few reasons for Governor Macklem to not keep the door open to further hikes, and the 25bp of additional tightening currently embedded in the CAD OIS curve (a spill-over from the Fed's pricing) are not something the BoC should be uncomfortable with.
- A largely unchanged message may ultimately have limited implications for CAD. We continue to expect a move below 1.3000 in USD/CAD by year-end, but that should mostly be the result of US dollar weakness and a generalised improvement in risk sentiment. CAD remains less attractive than the other dollar bloc currencies (AUD, NZD), which can benefit from more domestic tightening and exposure to the benign Chinese growth story.

National: Relatively Confident Of A Straightforward, Uncontroversial Affair

- The higher bar for additional rate increases has not been met and the Bank will therefore leave its overnight target unchanged at 4.5% on Wednesday.
- That call is in alignment with the broader consensus and OIS markets which have priced the probability of a 9th straight rate increase at effectively 0%.
- The decision won’t come with new projections, but the rate statement will provide a high-level opinion on how Governing Council views recent economic developments.
- Our expectation is that it says the economy is progressing “broadly as expected” which should give investors more confidence that April’s decision will result in no change too.
- A speech delivered by Carolyn Rogers on Thursday should reinforce this. After a year of frequent surprises on BoC days, we’re relatively confident this will be a straightforward, uncontroversial affair.

RBC: No Change Expected With No Further Hikes This Year

- The BoC is expected to leave the overnight rate unchanged on Wednesday—for the first time since the start of this hiking cycle in March of last year.
- The BoC committed to a “conditional pause” at its January meeting and data released since then (outside of those surprise January labour market numbers) has not met the relatively high bar needed to suggest a change in course.
- GDP data has been mixed, with a downside surprise on fourth quarter GDP growth offsetting the surprisingly firm 0.3% tick higher in the advance estimate for January. That left growth in the economy tracking slightly below the BoC’s January forecast.
- We still think the most likely scenario is that the BoC will not need to hike interest rates further this year. But that call hinges on whether the previous hikes are enough to slow consumer spending and labour market momentum in the months ahead.

Scotia: Little To Go From This Meeting But Hoping Renewed Hikes Considered In April or July

- No policy changes are expected, but the BoC has perhaps halted its hiking cycle prematurely. Recent developments have emphasized the choice is between further rate hikes to make sure that inflation will be brought durably lower, or a higher policy rate for longer which may rule out cuts for a long time, or higher inflation risk for longer.
- My preference would be for the BoC to return with further hikes and we may have enough information to evaluate this risk by either the April MPR or July MPR meetings.
- Expect a short statement. It may more succinctly spell out the conditional pause that has been expressed in clearer fashion in speeches and press conferences than the somewhat muddled message in the final paragraph of the January statement.
- That paragraph said that if their forecasts evolve as expected then they will hold the policy rate unchanged while assessing lagging effects of rate hikes, but they are prepared to hike again if needed depending upon how inflation evolves. They should repeat this tactic (of not more clearly saying they are done hiking) either by leaving the paragraph intact or with a simpler sentence.

- Expect acknowledgement of domestic progress but with continued caution that it is very tentative. My hope is that the BoC wouldn't emphasize Y/Y inflation gauges especially after the base effects disaster in 2021.
- Governor Macklem and SDG Rogers were surprisingly candid about their concerns last October when USDCAD had risen toward 1.39 and was threatening the 1.40 mark. At 1.36 today the currency has been back on a depreciating path over the past month and risks making the BoC uncomfortable again.

TD: Weaker Q4 GDP Gives BoC Breathing Room, CAD Focus On Global Narratives

- The downside surprise on Q4 GDP should allow the BoC to look past the blockbuster January jobs number and keep rates on hold at 4.50% (TD see rates on hold through 2023).
- The forward guidance is not expected to change too much from January, though the BoC might want to put more emphasis on the conditional nature of its pause.
- The labour report cleared the "high bar" component of the conditional pause, but one jobs print does not constitute an accumulation, and both the CPI and GDP figures gave the BoC some breathing room.
- The risk is that a "high bar" and an "accumulation of evidence" are not definite terms. The BoC's commitment to previous forward guidance has been inconsistent -- given the experience of the last 18 months, it would be reckless to completely rule rate hikes later this year.
- We'd argue that we need three conditions to be fulfilled for the BoC to cut rates: 1) Inflation that is below 3% and falling back to 2%, 2) growth that is materially below 2%, and 3) the economy back in excess supply. It can fudge the output gap estimate (e.g., Oct'21), but the first two conditions are less malleable.
- A low-energy BoC meeting would likely direct CAD's focus to the evolving global narratives. We see USDCAD holding the 1.33/1.37 range unless US inflation goes awry this month and prefer to play CAD on crosses where scaling into AUDCAD longs appeals to the shift in global growth drivers.
- In rates space, CAD long-end has risk / reward in its favor as the point to be on the curve both in a developed market context and in a domestic context.

UBS: No Hike In Sight, Expect Cuts To Start July As The Economy Enters Recession

- We expect that the BoC will leave the overnight rate unchanged at 4.5%.
- BoC's communication at the last meeting and during speeches in the last few weeks has been clear: policy sits on a conditional pause. Only if there is cumulative evidence (i.e. more than one datapoint) suggesting that inflation is higher relative to the forecast, will the BoC resume raising rates.
- Notably, the conditionality was based on inflation rather than employment so the strong January employment report likely won't lead the BoC to restart the hiking cycle.
- Over the last several weeks the market has materially reassessed higher its expectation of the Fed's terminal rate. We think that the BoC will avoid reacting to the more hawkish federal funds rate pricing. Deputy Governor Beaudry made a point of saying that the path to lower inflation might be different in Canada than in the US.
- We continue to expect a significant contraction Q2 and Q3 of this year that moves y/y inflation to the inflation-control target range of 1 to 3 percent. Against this backdrop, we expect that the BoC will start to cut rates at the July meeting as the economy enters into a recession.

MNI Policy Team Insights

MNI BOC WATCH: Macklem Seen On Hold, Affirming Longer Pause

By Greg Quinn, published Mar 2

OTTAWA (MNI) - The Bank of Canada is widely expected to leave interest rates unchanged at the highest level since 2007 Wednesday, reaffirming policymakers are done hiking unless inflation becomes stickier, with focus on how the statement frames risks around a hot job market and stalled economic growth.

The overnight rate on loans between commercial banks will remain at 4.5% according to all 22 economists surveyed by MNI. Experts also see little reason to change the last statement's key phrase -- the Bank probably won't hike again following eight consecutive moves and officials want to see how the economy responds to the strongest tightening cycle in decades.

While there's uncertainty around when inflation returns to the 2% target, recent data has solidified the view price gains have peaked and will continue fading. The Bank could reiterate its view CPI will slow to 3% in the middle of this year, either in the decision Wednesday or the "report card" speech and press conference Thursday with Senior Deputy Carolyn Rogers. (See: MNI INTERVIEW:BOC Sees Soft Landing In GDP Stall- Ex Govt Econ)

Policymakers have also said inflation will hit 2% sometime in 2024, though upside risks remain more important with price gains still running around 6%. Backing the case for slowing inflation is the GDP stall in the fourth quarter that lagged the Bank's forecast of a 1.3% annualized gain, helping pull back an overheated economy.

NEGATIVE REAL RATE

Governor Tiff Macklem has also said the economy could be flat in the first three quarters of this year and he's balancing risks of over- and under-tightening. The Bank's January hike of a quarter point matched the smallest move in a cycle that included a 100bp jump in July.

One challenge in the statement is squaring inflation and growth data with the job market. Employment gains shattered all forecasts in January and February, keeping wage gains above 4% and unemployment near record lows. The Bank may continue to downplay other survey data showing elevated inflation expectations by saying longer-term measures remain somewhat modest.

Canada’s policy rate remains negative versus the current rate of CPI and some measures of consumer inflation expectations over the next year or two.

Inflation slowed to 5.9% in January from 6.3% in December and June's 8.1% peak, led by the "base effect" comparison to last year's price jump around the Ukraine war. The Bank sets interest rates to keep inflation in the middle of a 1%-3% band and return to target within two years, and price gains have already topped 2% since March of 2021.

'ACCUMULATION OF EVIDENCE'

Canada is moving to the sidelines as Fed and ECB officials crank up rhetoric about the need for more hikes to subdue inflation, which central bankers during the upswing argued was a global and not a local phenomenon. While Canada's dollar could weaken if the Bank of Canada lags expected Fed hikes, Deputy Paul Beaudry said in a recent speech the currency could also strengthen over time if investors see inflation coming down faster in Canada.

Investors haven't been so resolute about a long pause in Canada, betting earlier this year on a rate cut towards the end of 2023 and more recently some saying a final quarter-point hike is possible in the next few months. Ex officials have told MNI the more likely case is a cut towards year-end. (See: MNI INTERVIEW: BOC Has Strong Case to Cut This Year-Ex Adviser and MNI INTERVIEW: BOC Seen Pausing Rest of Yr- CD Howe's Robson)

Canadians have racked up debts now worth more than the nation's GDP, raising the risk that tighter policy will do more than just cool demand.

Officials in January had no recorded discussions of hiking 50bps or a potential rate cut later this year, according to the first-ever set of published meeting minutes. The notes showed the decision to hike 25bps and signal a pause underlined officials "would need an accumulation of evidence" before considering another increase.

MNI INTERVIEW: BOC Sees Soft Landing In GDP Stall – Ex Govt Econ

By Greg Quinn, published Feb 28

The Bank of Canada will likely see weak fourth quarter GDP data released Tuesday as pointing to a welcome soft landing that will allow policymakers to follow through on the conditional commitment to pause after eight straight interest-rate hikes, former government economist Glen Hodgson told MNI.

“This is what a healthy slowdown looks like, what a soft landing looks like,” said Hodgson, a consultant who has worked at the federal finance department and trade finance bank, and advised governments as former chief economist at the Conference Board. Canadian output was 0.0% at an annualized pace, far less than than the market consensus for around 1.5% and the Bank of Canada's 1.3% estimate.

Investors have overstated the economy's downshift in recent months and the latest GDP figures continue to show resilience to the jump in interest rates and a shaky U.S. economy, Hodgson said. Canada's consumer spending rebounded in Q4, a weaker dollar supported exports and the inventory run-down that stalled GDP is more about a few industries anticipating slower growth than a genuine slump, he said.

“I don’t interpret it as a bad number,” Hodgson said of the GDP report. “The Bank should be pleased because we’ve gone through about a 400 basis point increase in interest rates over the past year, which is really slamming the brakes on.”

BRAKE IS WORKING

Governor Tiff Macklem has said the economy could be flat in the first three quarters of this year, helping restore balance to an overheated economy. The Bank in January hiked a quarter point to 4.5% and Macklem said he's likely done unless there's a rush of evidence higher rates aren't doing enough to restore 2% inflation.

“I personally don’t see the case right now for another increase in Canada,” Hodgson said. “You’ve already put your foot on the brake, the car has slowed down, there’s no need to slam on the brake any further.”

“It’s more likely that the next move by the Bank of Canada is going to be a rate cut, I wouldn’t be at all surprised now to see that happen before the end of 2023,” he said. With a soft landing in sight the Bank can pause even with the Fed poised for two or three more hikes, Hodgson argued.

He also contradicted others who say loose fiscal policy will keep the pressure on the Bank to look at more tightening. (See: MNI INTERVIEW: Deficit Means Little Scope For BOC Cut- Asselin)

BACK IN THE BOTTLE

Recent spending announcements are spread out over time and the last fiscal update showed the budget could be balanced within five years following record deficits at the height of the pandemic, he said.

“There’s no reason to add extra fiscal stimulus right now, even if the economy goes into recession,” Hodgson said. "The automatic stabilizers will be sufficient,” he said, referring to fiscal programs that shrink revenue and boost benefit outlays in any downturn.

While Canadian CPI remains elevated at around 6%, Hodgson said the last few reports have signaled trend inflation is most of the way back to 2% after peaking around 8% in June.

“We are slowly putting the inflation genie back in the bottle,” Hodgson said.

MNI INTERVIEW: BOC Seen Pausing Rest of Yr- CD Howe's Robson

By Greg Quinn, published Feb 23

Canada has good cause to keep interest rates steady for the rest of the year as past hikes drag inflation close to target and the cumulative tightening by global central banks slows demand, Bill Robson, head of the CD Howe Institute think-tank and its shadow monetary policy council, told MNI.

“I’m quite optimistic about the path of inflation—and I’m paid to worry,” said Robson, whose organization often hosts events with top central bankers and economic policy officials.

Investors haven't been so resolute about a long pause, betting earlier this year on a rate cut and more recently some saying a final quarter-point hike is possible in the next few months. Bank Governor Tiff Macklem says he expects to hold his 4.5% rate for a while unless there's an accumulation of evidence his forecast is off track for inflation to slow to 3% around mid-year and return to the 2% target in 2024.

“It wouldn’t be at all surprising to see the rate hikes the Bank of Canada has done already, and the Fed has done, work their way through the economy and continue to bring inflation down,” Robson said on MNI's FedSpeak podcast. The Bank's overnight rate has climbed from 0.25% since last March, one of the sternest campaigns in decades, and inflation has slowed from 8.1% in June to 5.9% last month.

GLOBAL OVERSHOOTING RISK

While the job market remains strong, it's "notorious" for being one of the last parts of the economy to show momentum swings, said Robson, whose organization also dates Canadian business cycles and recessions. Job gains are also a hopeful sign that the economy can avoid a painful downturn, he said.

“We’re going to continue to see consumers pulling back in more interest-rate sensitive areas,” he said. “It’s likely that we are going to see at least a couple of very soft quarters, it wouldn’t be at all surprising to see a couple of negative quarters.” (See: MNI INTERVIEW: BOC Has Strong Case to Cut This Year-Ex Adviser)

Central banks collectively face an overshooting risk, Robson said, similar to how looser fiscal and monetary policy during Covid contributed to the inflation wave. “When everybody is doing the same thing, it does heighten that risk, and so one of the things that we may have to deal with is some accident, some source of unexpected financial pressure.”

Restoring inflation to 2% next year will also help the Bank of Canada fend off recent political criticism and avoid more meddling the next time its mandate is up for renewal with the government, Robson said. The last renewal added unhelpful clutter by inserting language about seeking full employment when the inflation target is being met, he said.

CANADIAN DOT PLOT?

"There was clearly more than one set of fingers on the keyboard at that last mandate renewal,” he said. “What I would like to see in the next round is the whole thing getting kind of cleaned up.”

The recent move to publish meeting minutes will help deliver the inflation message, though it would be nice to go further and consider a group of outside policy makers and publish an expected path of interest rates, Robson said. One challenge is that only the Governor is legally responsible for monetary policy, so a Fed-style dot plot is probably unworkable.

While officials at the Bank see those moves as too strong, Robson noted inflation targeting was also originally seen as a fairly radical innovation when it began in the 1990s.

“The greater degree of transparency gives you a lot more nuance, and I think people’s discussions of Fed policy are better because they can see how the members are thinking and how they are thinking differently,” he said.