BoC Preview — Playing The Waiting Game

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The Bank of Canada is expected to maintain its overnight rate at 0.5% tomorrow in what is likely to be a low-risk placeholder on the calendar. Consensus is unanimous in expecting a hold and OIS markets are assigning a 97% probability to no rate change but obviously the tail risk would be a cut rather than a hike. It will be a statement-only affair at 10amET sans press conference and forecasts. The next full-fledged meeting with fresh forecasts will be on January 20th. Our forecast is for the BoC to be on hold throughout the next year.

Why no cut? Because BoC Governor Poloz came about as close to saying so without actually spelling out the words 'no cut'. Recall the recent money quote on this topic in Poloz's Bloomberg interview on November 29th that sets a high bar against further easing at this juncture:

Bloomberg's Question: "The door may be open to more monetary stimulus. Does the economy need to be significantly weaker than it is now to consider other further stimulus options?"

Poloz's Answer: "We frame this in terms of the outlook for inflation. Right now it looks to us like we can have inflation back at target, coming from below, around the middle of 2018, and that's a reasonable time frame over which to keep your inflation on target. It would require for us to have a significant departure in that outlook, such as we had in the case in the oil price shock."

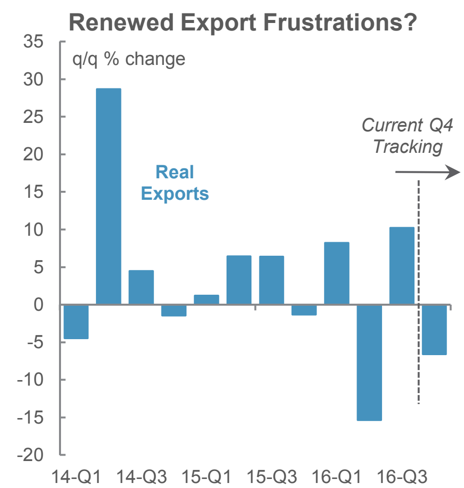
Granted, the central bank has communicated somewhat erratically of late but has probably committed itself to a prolonged pause as new information is digested. In the October 19th press conference, Governor Poloz surprised markets by stating that the Governing Council had "actively" considered a rate cut. One might have thought that the US election since reinforced this bias, but it was not repeated in recent communications that had Poloz stating "We only incorporate actually announced policy changes, and there haven't been any of those." The reticence to be as clear on the bias in the October statement — as opposed to the press conference — and in more recent communications probably means markets shouldn't expect a terribly clear bias from the pending update but the statement will likely lean that way and be peppered with references to uncertainty. Poloz's recent remark that "We will just have to wait a little longer to understand that and continue to read sentiment" also applied to interpreting the risk of a shift in US trade policy.

So what evidence is the BoC waiting on to further inform a likely long-pause bias?

1. **Core inflation**: They shifted to a new batch of three preferred measures in the five-year renewal of the inflation targeting regime and none of them will be published by StatsCan until the CPI report later this month. The last update that was provided by the BoC was in August and back then the common-component CPI registered at +1.6% y/y.

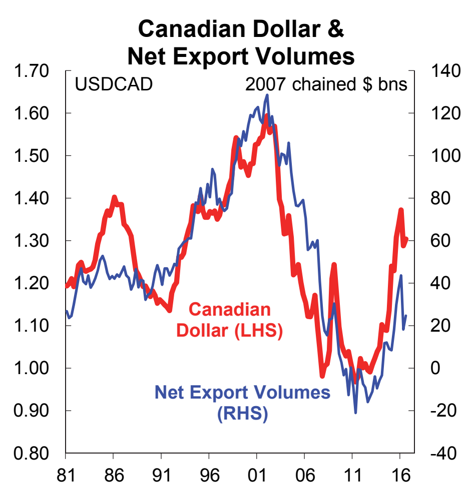
2. **Exports:** The volume of exports is tracking an annualized 6.6% q/q decline in Q4 so far based upon the Q3 hand-off and October data. That follows a roughly 10% gain in Q3. As chart 1 demonstrates, the pattern of false starts to export gains that were often built upon transitory factors looks set to repeat itself. Having said that, letting chart 2 speak for itself may suggest it's too early to give up on exports.

Chart 1



Source: Scotiabank Economics, Statistics Canada.

Chart 2



Source: Scotiabank Economics, Statistics Canada.

3. **US trade policy**. The uncertainty over NAFTA and the broader global rules of trade needs to be clarified by the US administration.

4. **Evidence on investment intentions**. Is uncertainty over NAFTA causing boardrooms to postpone or scale back investment plans? The first sign may come with the BoC's next quarterly Business Outlook Survey that arrives before the next policy decision in January and that will capture a post-US election sample period.

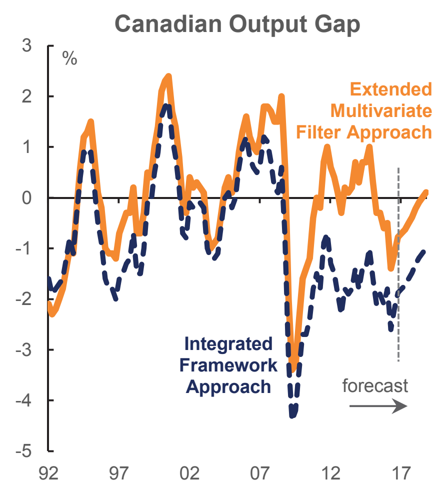
5. **The Fed's dots — and its actions**. There is a limit to the extent to which the BoC can fall behind the Fed in raising rates and that limit is expressed through avoiding a tailspin by USDCAD that would court imported inflation and a national pay-cut. Recall that the BoC began shifting its message when USDCAD crossed the mid-1.30s and then moved north of 1.40 earlier in the year.

6. **Stimulus effects**: We're largely still waiting to see if child benefits, higher immigration, infrastructure plans and tax cuts for lower- and middle-class earners are working to stimulate the economy in offsetting fashion to higher taxes for upper income earners, carbon taxes, and higher electricity prices especially in Ontario. Thus far the evidence has been rather deficient but these are slow-fuse forms of stimulus that will take time to assess.

7. **Are tighter mortgage rules working to dampen housing demand?** Perhaps in Vancouver, but not yet elsewhere, especially Toronto. Tightened mortgage rules probably don't lessen rate sensitivity on the mortgage book, in my opinion.

Given these considerations, it probably makes sense for the BoC to keep its powder dry for now as another cut would put housing policies at odds with each other and a hike is not in the cards amidst such questions. The BoC's forecast for spare capacity to close by mid-2018 may be optimistic (it usually says the gap will shut within its forecast horizon). Both of its gap measures are unlikely to close until well beyond then (chart 3). When combined with Canada's high debt that magnifies the consequences of adverse shocks, a defensive posture by the BoC is likely for a considerable period. Against this must be weighed numerous positives. One is that the energy shock is maturing in terms of incremental risks it poses to broad national GDP growth and jobs. Another is that much higher child benefit payments represent tangible, but slow moving stimulus to the household sector. Higher immigration targets will lift household formations in the 3-4 main cities where immigrants tend to converge. And of course infrastructure spending is unfolding over our forecast horizon.

Chart 3



Source: Scotiabank Economics, Bank of Canada.

In terms of statement specifics, it's likely we'll see a nearly full re-write since the last statement (here) was accompanied by a fresh Monetary Policy Report that included an explanation of forecast revisions that we won't see again until next month. That said, here are a few areas where there could be wording changes and it's the final one that would tilt toward a mildly dovish bias:

Paragraph 2: "However, because of elevated uncertainty, US business investment is on a lower track than expected."

[Risk: core capital goods orders have risen in four of past five months).

Paragraph 2: "Looking through the choppiness of recent data, the profile for growth in Canada is now lower than projected in July's *Monetary Policy Report* (MPR). This is due in large part to slower near-term housing resale activity and a lower trajectory for exports."

[Risk: Repeat Poloz's recent guidance that 2016H2 growth is on track with the October MPR which signals they are sticking to a similar story].

Paragraph 2: "Recent export data are improving but are not strong enough to make up for ground lost during the first half of 2016, despite the effects of the Canadian dollar's past depreciation."

[Risk: Exports are weakening again after a brief pick-up].