BoC Preview — Too Early For Shorts

Next Wednesday's Bank of Canada meeting will end in a statement-only affair at 10amET sans forecast updates or a press conference. The overnight lending rate is universally expected to remain at 0.5% both in terms of the consensus of economists and market-derived probabilities. The bigger issue is whether the bias will be incrementally altered, particularly in the context of a pile-on that has been shorting the Canadian dollar (chart 1) and going long on the front-end of the Canada curve at least until very recent developments. This has been in anticipation of incrementally more bearish news for the economy and financial system—and the Bank of Canada's possible response.

I think such expectations are likely to be disappointed next week. For one thing, Governor Poloz has already largely dismissed emphasis upon Home Capital's challenges by stating they are 'unique' and 'idiosyncratic' as opposed to representing system-wide contagion effects. In tipping his hand before the main event, it was a pretty strong signal that, while the BoC remains concerned about various risks to financial stability and particularly housing, that concern has not escalated of late when compared to the full set of communications offered on April 12^{th}. That approach makes sense.

Second, growth is ripping. Growth is presently tracking around a 4% annualized print which is in line with revised BoC expectations last month and materially higher than the 2.5% forecast in January. Growth has exceeded everyone's expectations in Q1 compared to the start of the year. That, in turn, would be the third consecutive quarter of solid growth albeit with heavy import distortions. Contrast that to the stronger case for a serially disappointing economy in 2015 when only one single quarter notched growth over 1% (chart 2). As a consequence, the traditional 'extended multivariate filter' definition of the output gap is likely shut, while the 'integrated framework' measure still signals significant slack.

Third, the BoC is likely to repeat that weak Q1 US growth was transitory and "the drivers of growth remain solid." That remains to be proven, but very early tracking of Q2 growth data is supportive of a materially stronger economy than the paltry 0.7% annualized growth in Q1. Clearly US political and policy risks overhang the outlook for markets and the US economy such that the BoC won't be signaling any greater optimism at this highly uncertain juncture. Also consider that the nearly four cent depreciation in the C$ versus the USD since the April 12th statement is a risk mitigant to financial conditions.

So why not go the other direction with a hawkish bias?

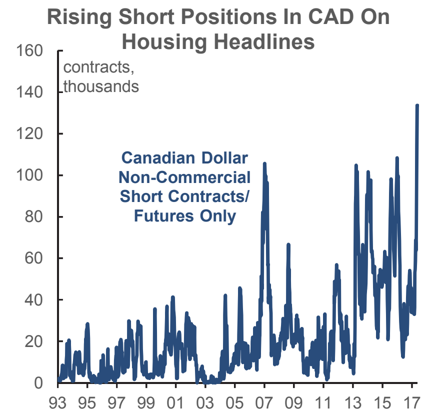
- Core inflation measures have been trending down and further beneath the BoC's target for headline inflation over the past year (chart 3). The connection between output gaps and inflation is modest and should not drive mechanistic policy rules.
- The ink is barely dry on the April MPR forecasts and the next one is due in July.
- Accommodative monetary policy is needed in the face of a very mature household cycle absent convincing signs that exports and investment can take over.
- A 90-day consultation period has been triggered by the US administration to begin renegotiation of NAFTA in the context of a soft backdrop for exports.

All of which means little likelihood of a material shift from a "decidedly neutral" stance.

CONTACTS

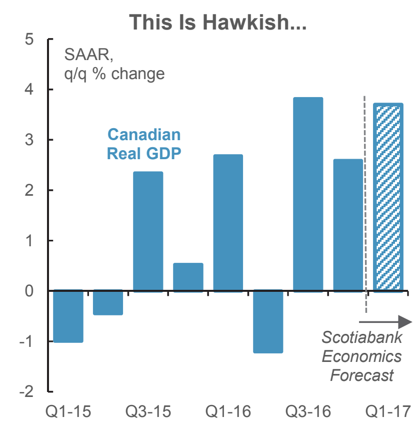
Derek Holt, VP & Head of Capital Markets Economics
416.863.7707
Scotiabank Economics
derek.holt@scotiabank.com

Chart 1



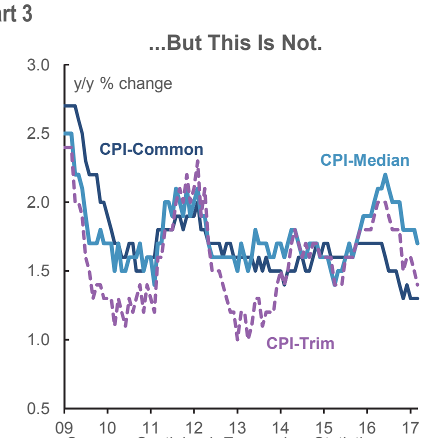
Sources: Scotiabank Economics, Commodity Futures Trading Commission.

Chart 2



Sources: Scotiabank Economics, Statistics Canada.

Chart 3



Sources: Scotiabank Economics, Statistics Canada.