BoC Expands Bond Buying to C$250–350 Billion

- **The BoC expanded its unconventional easing…**
- **…by adding provincial bond purchases…**
- **…adding investment grade corporate bond purchases…**
- **…increasing its t-bill auction purchases…**
- **…increasing GoC purchase guidance…**
- **….and lengthening its term repo facility**
- **Yield curve control was ruled out at least until the recovery phase**
- **No forecasts were issued…**
- **…but Poloz guided preference for a V-shaped outcome…**
- **…marked by prolonged downside risk to inflation…**
- **...which indicates rates to stay low for very long**
- **Focus turns to Ottawa's provincial and sector aid**
- **The BoC is still not out of ammo**
- **Negative rates continue to be ruled out**
- **Poloz's successor may be announced imminently**

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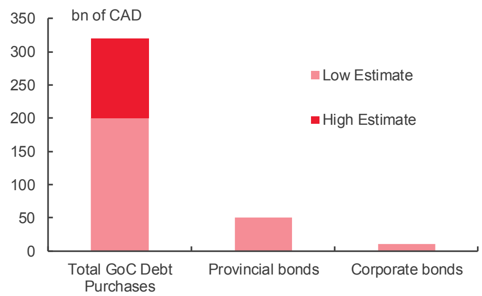
The Bank of Canada generally met our expectations for a material lurch forward in the provision of new stimulus. A roughly 10% contraction in the economy during Q1 (here) added last minute cover, although clearly decisions were made well before. The central bank almost went all-in on stimulus efforts today but still retains considerable firepower if needed. A summary of the steps that were taken is provided below. The statement is here, the MPR is here and Governor Poloz's opening press conference remarks are here. Individual market announcements will be noted below. Full analysis and commentary combines all communications from the BoC.

The expanded bond purchase program adds at least C$60 billion worth or bonds to the BoC's don't-call-it-QE-call-it-LSAP program that was already buying an estimated C$200–300 billion of GoC bonds over the next year or more. In total, the BoC will buy a roughly estimated C$250–350 billion worth of Canadas, provies and corporates and maybe more (chart 1).

Estimated Value of BoC Bond Purchase Programs in Response to COVID-19



Source: Scotiabank Economics.

- The market effects were mixed and skewed toward new targets, likely because of rising anticipation the BoC was on the verge of materially expanding stimulus.

- Provincial bond yields rallied big time. For example, Ontario's bond yields are down by about 23–24bps in 10s and hence narrowing over the rally in Canada 10s that is under half that.

- The C$ was already depreciating into the announcements and slightly thereafter by a total of two-and-a-half cents to the USD but has since regained some of that depreciation and is middle of the pack among all major currencies to the dollar today.

- The Canada two year yield was rallying by about 5bps on the day and slightly cheapened following the announcements.

- The ten year GoC rallied about 10bps on the day but with little effect after the announcements. Canada is not particularly outperforming the US in either 2s or 10s today given the partial focus upon awful data including the nearly 9% m/m drop in US retail sales and the 10% annualized contraction in Q1 Canadian GDP using StatsCan's 'nowcast' estimate.

- Stocks failed to benefit. The TSX is down 1.5% so far today but the pace of decline has slightly diminished post-releases.

EXPANDED STIMULUS

Here is what the BoC introduced.

1. **A new facility to purchase provincial bonds was introduced (here).** The BoC will buy up to C$50 billion of bonds in the secondary market issued by all provinces and their fully guaranteed agencies with terms to maturity up to ten years. The program will run for one year and commence in early May. Watch for further announcements in the lead up to the first purchases. I have a feeling they're going to be expanding the size of this program. A prime motivation that was offered for introducing this program was the comment in the press conference that there will be extra demands through cash management across all levels of governments and with greater liquidity demand the BoC's job is to provide that liquidity and target markets where it is likely to occur, like provincial bonds. This is consistent with one of my main arguments that they should get ahead of this surge rather than risk catching up.

2. **A new facility to purchase corporate bonds was introduced (here).** Starting in early May, the BoC will buy up to C$10 billion of bonds in the secondary market. Purchases will be restricted to senior secured and unsecured bonds originated by Canadian incorporated companies with a remaining maturity of five years and a rating of BBB or better. Deposit-taking institutions will be excluded on the double dipping argument as the BoC noted "their access to other support facilities by the Bank of Canada." The program will also run for one year and parameters "may be expanded if conditions warrant." Here too, I wouldn't be surprised to see the program size and duration increase. That said, I can't see them buying junk given a) it's a smaller market overall in Canada than US, b) several parts of it are guaranteed to go under so immediate credit risk would be taken by the BoC and c) the hope is other fiscal/monetary policy instruments will carry knock on effects.

3. **The BoC will increase the size of the t-bills market it takes down to up to 40% of issues at auction** 'until further notice' from 25% previously (here). This takes effect immediately.

4. **The main statement itself (recall here) indicated that the size of the Government of Canada bond purchase program will be increased** from "at least C$5 billion" per week to an unspecified higher amount "as required to maintain proper functioning of the government bond market."

5. **The BoC will extend the term repo facility** to permit funding for up to two years from one year previously. Prior details are available here.

Forecast Guidance

The BoC took a page from the Fed and issued no forecasts this morning with Poloz saying they don't wish to provide 'false precision' and don't view themselves as being in a forecasting contest. Recall the Fed went on a forecasting hiatus until the June FOMC. Both central banks basically argue that it's futile attempting guesswork in the present environment.

On growth, Poloz only went so far as to outline a best case scenario marked by a V-shaped rebound starting as containment measures begin to lift into late May or early June and gradually transitioning toward releasing pent-up demand. That is broadly consistent with present guidance on the length of the shut-ins. Poloz said that was his preferred scenario, but an alternative one would extend that by a couple of months and lead to a deeper downturn and more gradual recovery.

On inflation, Poloz noted in the press conference that the net effects of supply and demand shocks is likely more skewed toward downside risks for a longer period and "This is why we are orchestrating all of this stimulus" given their inflation mandate. He also described a process of fits and starts as supply and demand come back along different timelines and with differing magnitudes. Overall, this sounds broadly similar to the IMF's projection for inflation (here) when they forecast headline Canadian inflation to be 0.6% y/y in 2020 and 1.3% y/y in 2021. There will also be data quality issues with CPI as Statistics Canada deals with incomplete or entirely absent markets and the difficulty in assessing prices if there is no activity around them. This may make for weakened data quality at least during the shutdown and early recovery phases as markets gradually get restored.

Markets would likely only protest this lack of forecasts because forecast anchors might have better informed estimates of the eventual size of the GoC bond purchase program given the guidance it will last until the recovery is 'well underway.' For instance, forecasting the magnitude of the rebound and when the massive expansion of spare capacity would begin to erode could have been useful information to firming parameters around the bond purchase program. In my personal bias, it's unclear this is a misstep. Granted, the BoC has a zillion economists who just got a free pass, by contrast to our Economics group that rightly figures guesswork around huge uncertainties is still useful by incorporating rolling evidence. Yet there is enormous guesswork involved and Governing Council management time likely preferred focusing upon stimulus program efforts and details rather than reviewing staff projections and debating what to go with. It's bad, add a tonne of stimulus, move on and reassess later. But they won't get quite the same free pass if they turn agnostic toward attempting forecasts the next time!

Further Stimulus Options

Now the focus shifts toward marrying this monetary policy stimulus to likely Federal aid to provinces and sectors. A First Ministers meeting is scheduled for tomorrow after Prime Minister Trudeau guided yesterday that further aid would be forthcoming shortly. Be on watch for announcements over the duration of today into tomorrow. It's unlikely that a First Ministers meeting would be disappointed!

Is the BoC now out of ammunition? Not at all. Wilkins address this in part, but here are further comments interwoven with her remarks and comments from the Governor.

1. Yield curve control:

Don't hold your breath. Poloz pretty much ruled out yield curve targeting for the foreseeable future and Wilkins basically indicated (and rightly) that the BoC's influences may extend out to the 3–5 year section of the curve (but probably not further). He did so in a roundabout and somewhat contentious way by first explaining the difference between Large Scale Asset Purchases - that the BoC is doing - versus interpreting this as a quantitative easing program that Poloz says it not the present aim. He reasoned that the objective of LSAPs is to bring more order to markets whereas the objective of QE which is to lower longer term interest rates. Since the BoC's efforts are aimed at LSAPs versus QE and because yield curve targeting is more consistent with a QE program, Poloz said it wouldn't be part of the toolkit. He backed that up by observing the very low 10 year GoC bond yield in an economy that is 'turned off' and how a yield curve control target wouldn't achieve much now.

In future, however, Poloz indicated that yield curve control could be considered in the recovery phase when the BoC may need to employ rate controls and QE but 'those deliberations can wait for another day.'

My view is that the BoC is being a bit cute drawing the distinction between LSAPs and QE. Call it what you will, but lower long-term borrowing costs are the result and so yield curve control would not be inconsistent with present policy aims. The argument about being more important if markets get ahead of themselves and overly tighten financial conditions in a recovery is valid, but it remains questionable whether the BoC can have a sustained impact through yield curve control efforts in that stage.

2. Funding for lending

Wilkins explicitly fingered a program to offer very cheap financing to lenders if they lender to small- and medium-sized enterprises. This would be like the BoE's program. She did caution, however, that there are existing Federal government programs with the inference being that policy wouldn't wish to overlap or be at loggerheads. That said, the problem remains the proverbial challenge of how you can lead a horse to water but can't force him to drink. Lenders still need profitable lending opportunities backed by sound business cases.

3. Negative rates

In case you missed the memo provided at the last BoC presser, negative rates are not part of the BoC's toolkit. They once were, but they've had a change of heart. It's not impossible this changes again, particularly as leadership changes and with probable knock-on effects on the Governing Council, but the message is that they would be pursued at best only after all other avenues have been explored. I'm not sure I want to see that state of the world!

4. Further credit easing

Wilkins indicated that the BoC could focus more upon the pricing of credit even in a functioning market. This would amount to expanding current initiatives, or possibly adding new ones. This is exactly the point I've been making in terms of not ruling out provincial bond purchases just because issuers are able to issue. Wilkins basically indicated they could expand program size and other parameters to force pricing to where they believe the markets need to go. Further to this, Wilkins noted that "I wouldn't pretend the conditions in markets particularly in terms past one year are particularly functioning well."

While it was not mentioned in the presser, one could also add other potential programs such as something akin to the Fed's Mainstreet Business Lending Program, or crossing the line more overtly toward directly funding government at least temporarily and somewhat akin to what the BoE did recently.

Poloz's Successor May Soon be Announced

Governor Poloz yet again confirmed that this will be his last full meeting and press conference (barring emergency meetings of course). He will step down on June 2nd, one day ahead of the next scheduled meeting. He indicated that the process to search for his replacement is "90% complete" while referencing that the BoC is about more than the Governor who just 'gets to wear the 'C' on the jersey' as Poloz put it with some humility and is instead about a vast team. Given the 90% mark and that there are only less than seven weeks left in Governor Poloz's term, an announcement should be expected any day now. We naturally won't speculate for obvious reasons (so stop asking!).