RBC Economics

Daily Economic Update

July 14, 2021

BoC continues to taper QE but rates guidance unchanged

- Quantitative easing (QE) reduced to $2B per week as expected
- BoC still signaling rates on hold until H2/22
- Inflation forecasts revised higher but above-target readings still seen as transitory

The key elements of today's policy announcement were as anticipated but the BoC injected a bit more optimism into the proceedings than we expected, albeit while still emphasizing a great deal of uncertainty. Markets saw it as slightly dovish (Canadian dollar and bond yields modestly lower post-meeting) likely due to ongoing emphasis on the transitory nature of inflation (but with a bit more nuance in our view) and emphasis on labour market slack. But we also think it would have been difficult for the bank to surprise hawkish with markets having increased BoC rate hike expectations since the Fed's June meeting. We continue to look for rate hikes to begin in H2/22.

Key policies as expected: The bank is reducing asset purchases under its QE program to $2B per week from $3B, in line with our expectations and market consensus. This continues a process that began last October and we expect will culminate in the bank shifting to reinvestment only (i.e. zero net bond purchases) around the turn of the year. The bank's forward guidance that the overnight rate will remain at its current level until the economy returns full capacity in the second half of 2022 was unchanged and is in line with our forecast for two rate hikes in H2/22.

Growth forecasts revised higher: The bank revised its global growth forecasts higher thanks in part to additional fiscal stimulus in the US and generally stronger consumer spending expectations. It also marked its domestic growth forecast quite a bit higher (on net) with GDP now expected to be 3/4 ppt higher at the end of 2022 relative to April's projection. The bank's consumer survey released last week—showing Canadians are likely to spend some of the excess savings accumulated over the past year—prompted an upward revision to consumer spending forecasts. The BoC also cited improving business confidence and terms of trade as supporting growth. Stronger expected investment (along with less labour market scarring) saw the bank revise its potential growth projections higher, offsetting some of the upward revision to growth to leave the timing of output gap closure unchanged relative to April. The bank emphasized significant uncertainty around the degree of economic slack and the timing for when it will be absorbed.

Bank says inflation increase will be transitory: As expected, the bank revised its inflation forecasts higher (+0.7 ppts in 2021 and +0.5 ppts in 2022, both on an annual average basis) but maintained that the current and forthcoming period of above-target inflation will prove transitory. It cited a number of factors driving the increase including energy prices, base effects and supply disruptions, and expects inflation will fall back to 2% as those pressures ease. However, it said the "persistence and magnitude" of those factors is uncertain and will be monitored closely. That seems to indicate a touch more concern about above-target inflation than the bank has previously expressed but isn't a significant change in tone. It's also worth noting that the BoC sees inflation only temporarily falling back toward its 2% target in H2/22 before rising again in 2023 when the economy is in modest excess demand.

Watching the labour market recovery: The bank took note of June's encouraging jobs numbers and expects employment will continue to rebound, including in the hardest-hit sectors of the labour market, as re-opening proceeds. However, more than half a million jobs still need to be added to get the employment rate back to its pre-pandemic level, and it could take time for vacancies to be filled given potential skills mismatches. The bank mentioned a number of labour market indicators it will be watching as gauges of economic slack but Governor Macklem made it clear that the BoC is targeting inflation and not specific labour market outcomes. At the risk of reading too much into one comment, that perhaps throws some cold water on the bank potentially adopting a dual mandate following this year's inflation target renewal.

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