

April 22, 2021

Forecast update: Stronger growth → more hawkish BoC → earlier hikes

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- This special mid-month update outlines our revised thinking on Canada's monetary policy posture in the wake of Wednesday's interest rate decision. Given the BoC's much-improved growth outlook, earlier closure of the output gap and revised forward guidance, it's appropriate to bring forward the first BoC interest rate hike. Quite simply, we had assumed more forceful macroprudential measures to address overheated housing markets, but the tweaks we've seen so far appear unlikely to materially cool things off. Moreover, the front-loaded, max fiscal stimulus effort delivered in this week's federal budget introduces additional upside. Provinces too continue to provide exceptional supports. We believe the Bank's first hike is now most likely to arrive in October 2022, a handful of months after reaching a net neutral QE pace and as we close in on full employment. That's one quarter earlier than our prior forecast. If anything, our bias is asymmetric; that is, a 2022:Q3 hike may be more likely than the Bank waiting until 2023:Q1, although much will depend on the Fed's policy stance. Markets have generally been moving to discount a more aggressive timeline for monetary tightening, 2s underperforming on the curve and Canada drifting wider to the US across the curve.
- Wednesday's rate decision delivered, as expected, a tapering of QE, with the weekly pace moderating from C\$4 billion to a net C\$3 billion. More surprising was the decision to leave the composition of purchases largely unchanged across the term structure. To us, allocating a larger share of purchases to longer tenors would better align with the amped up term out effort outlined in a fresh *Debt Management Strategy*. The current misalignment of BoC purchases and GoC issuance could leave Canadian longer-term yields under pressure.
- Respectfully, the Bank's messaging on QE could still be improved/clarified, particularly as it relates to the distinction between gross and net purchases. We'll once more petition strongly for greater transparency and disclosure on key labour market variables, at a minimum adding an unemployment rate forecast to the BoC's main outlook table. This isn't too much to ask, particularly now that the Bank concedes its assessment of slack will be broader in nature and less fixated on the output gap. The communication on core inflation remains muddy; there are too many inflation measures to track. Simplify please.
- Less altered (for now) is our thinking on Fed hikes. Powell and Co. have yet to tee up a taper south of the border. Saying that, a robust recovery and mounting inflation threat will make a strong case for an unwind of monetary accommodation. We'll be looking for hints in that direction as early as June. Some might argue that Biden's super-sized fiscal package, and all the bonds it will breed, forever lock the Fed into QE. We tend to disagree, although clearly the eventual taper will need to be gradual and well communicated (e.g., 3 months notice + 12-15 months to wind down). For now, we've kept our first Fed hike in 2023:Q1. With the Bank thus looking to move a bit ahead of the Fed, and the BoC taper progressing, we've greater conviction in our 1.20 CAD call. We may arrive there earlier than scheduled.

United States

Quarters	Fed Fund	3 Mth Bill	2YR	5YR	10YR	30YR
04/22/21	0.25	0.02	0.15	0.80	1.55	2.24
Q2	0.25	0.05	0.20	0.95	1.70	2.35
Q3	0.25	0.05	0.25	1.10	1.85	2.45
Q4	0.25	0.05	0.30	1.20	2.00	2.55
Q1/22	0.25	0.10	0.40	1.35	2.05	2.65
Q2	0.25	0.10	0.55	1.45	2.15	2.70
Q3	0.25	0.15	0.75	1.55	2.20	2.75
Q4	0.25	0.15	0.95	1.65	2.25	2.80
Q1/23	0.50	0.45	1.15	1.80	2.40	2.85
Q2	0.75	0.70	1.30	1.90	2.50	2.90

Canada

Quarters	Overnight	3 Mth Bill	2YR	5YR	10YR	30YR
04/22/21	0.25	0.09	0.31	0.94	1.51	2.03
Q2	0.25	0.10	0.35	1.05	1.70	2.15
Q3	0.25	0.15	0.45	1.15	1.85	2.25
Q4	0.25	0.15	0.55	1.25	2.00	2.35
Q1/22	0.25	0.20	0.70	1.40	2.10	2.45
Q2	0.25	0.25	0.80	1.50	2.20	2.55
Q3	0.25	0.35	0.95	1.65	2.30	2.60
Q4	0.50	0.60	1.15	1.85	2.40	2.65
Q1/23	0.75	0.80	1.35	1.95	2.45	2.70
Q2	1.00	1.10	1.50	2.05	2.50	2.70

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