Bank of Canada adds to its playbook to improve transmission

15th April 2020

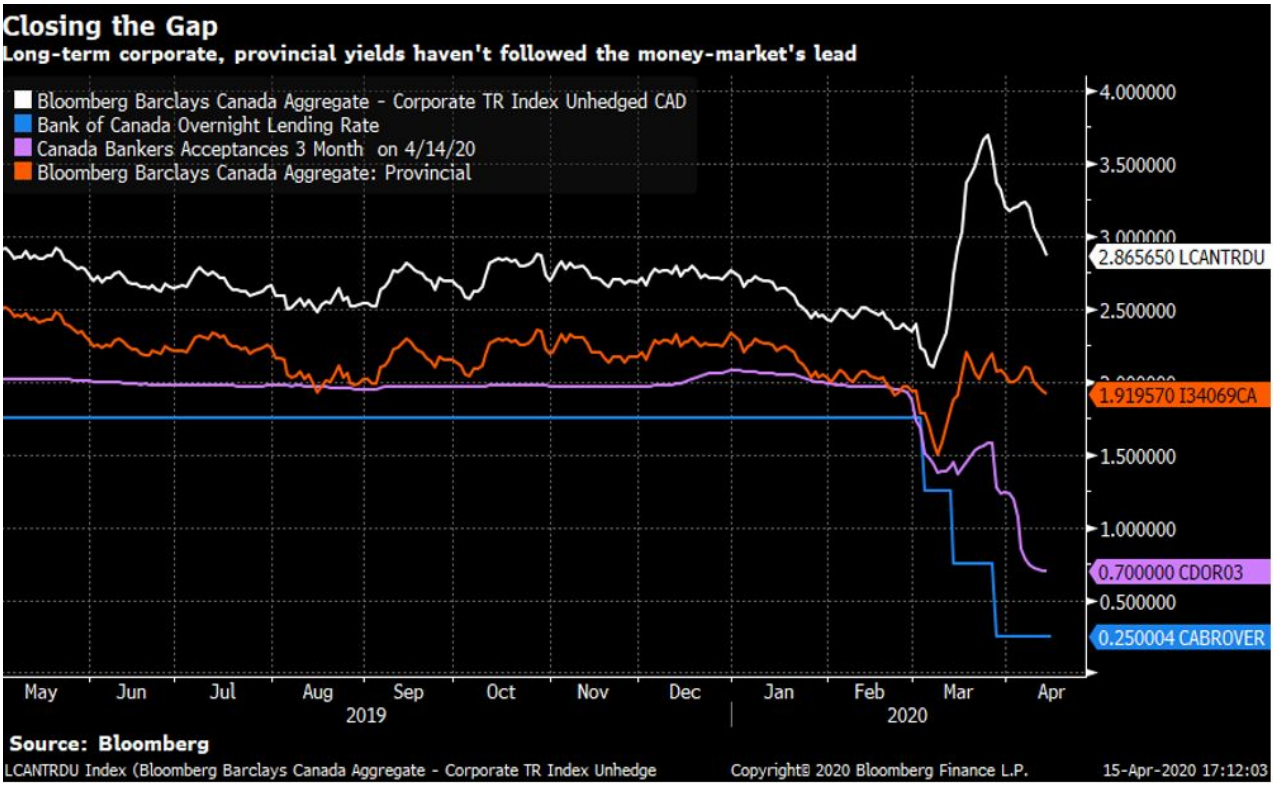
The latest swathe of Bank of Canada measures sees the Governing Council continue targeting the functionality of markets and aiming to improve the transmission mechanism of policy rates as opposed to adding to its balance sheet to directly improve growth conditions.

> This suggests the bank hasn't taken the step towards using unconventional tools such as QE to stimulate the economy, and will instead aim at letting the 150bps of rate cuts implemented last month do the heavy lifting.

This was evident in the new measures unveiled today which will see the central bank purchase up to C$10bn in investment-grade corporate debt and C$50bn in provincial bonds.

The new Provincial Bond Purchase Program and Corporate Bond Purchase Program add to the measures already taken to improve credit conditions and lower the cost of debt issuance in markets. While this has worked in Bankers Acceptances and Treasury Bill markets concerns still lingered in corporate and provincial debt markets, with spreads widening from the overnight lending rate.

Graph 1: Corporate and provincial debt yields forced the BoC measures today



For now, the Bank of Canada has defied our expectations of increasing the rate of sovereign purchases from the current $5bn a week, but once market functionality is restored, we maintain the belief that this mechanism will preclude any changes in more conventional policy. Limited information was given in today's Q&A, which is set to be one of Governor Poloz's last in charge of the central bank, especially as the Monetary Policy Report avoided any concrete forecasts.

The bank did forecast that growth was likely to contract by 15-30% in Q2 compared to the benchmark rate set in Q4 2019, but the exiting Governor remained optimistic of a V-shaped recovery given the joint stimulus reactions.

In FX markets, the loonie slid on the news of further monetary loosening to join G10 currencies such as AUD and NZD to suffer losses just shy of 2% on the day as oil markets also felt the pain of a record build in US inventories. The measures taken by the BoC merely added to the pressure imposed on the Canadian dollar rather than being the sole driver of the currency depreciation. Going forward, we believe conditions will continue to provide heightened volatility for the currency pair, with USDCAD struggling to make a structural break below the $1.40 level without a material upswing in current conditions. This could include a sustainable rally in the oil market, a broad bout of dollar weakness, or the beginning of containment policies being unwound. In the absence of such events, we expect USDCAD to be well supported around the $1.40 level.

Graph 2: Loonie back up above 1.40 as pressure on rally mounts

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