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BoC March Decision – Short-Term COVID Uncertainty and the Uneven Recovery Lead the BoC to Err on the Side of Caution

Progress on the vaccine rollout improves the medium-term global outlook and propels commodity prices higher, a constructive development for future economic growth in Canada. Also, additional U.S. fiscal support cited as an upside risk in the January *MPR* has materialized with Congress on the verge of passing the US$1.9T stimulus package. Biden's new plan is a centerpiece of the major upward revisions to real GDP growth projections released earlier this week by the OECD. The BoC thinks the same way. Interestingly, the Washington-based Brookings Institution estimates that the US$1.9T package will lead the U.S. economy to reach its pre-pandemic level faster than most countries, in 2021Q3. Also, the BoC feels more confident about the U.S. recovery because "*virus infections decline*".

The Canadian bond market tends to see the glass half full and expects a quick removal of monetary easing justified by above trend GDP growth numbers generating a permanent rise in CPI inflation. In contrast, BoC officials do not get ahead of themselves, first and foremost because new variants could still emerge. Of course, the BoC view on that front could change within the next couple of months with mass vaccination starting in Canada. Without mass vaccination reducing COVID uncertainty, it will be difficult for the BoC to signal the tapering of the GoCs purchase program. The context appears more favourable to announce a tapering in June or later this summer instead of April. Furthermore, it is also not clear to us the pace of weekly GoCs purchases will go down to $4B to $3B to begin with as some market participants suggest.

Today's statement set the record straight about CPI inflation temporarily spiking between 2-3%, an outcome we forecast for 2021Q2 like the BoC. But the mix of ingredients required for a sustainable CPI inflation rate at the 2% target is not there in our view: lack of private credit growth, lack of pricing power for businesses, above trend unemployment for the next two years, etc. The BoC still does not foresee CPI inflation at the 2% on a sustainable basis until 2023, repeating the same message than in January. This marks a big contrast with the rising inflation risk premium in markets observed so far this year.

Today's statement notably focuses on one weak link of the economy: the slow progress in labour market conditions. "*The labour market is a long way from recovery, with employment still well below pre-COVID levels. Low-wage workers, young people and women have borne the brunt of the job losses*". In our view, the BoC echoes the U.S. Federal Reserve although only the latter officially adopted an inclusive employment maximisation mandate. The growing consideration of the widely uneven labour market as a factor influencing the stance of monetary policy should contribute to put a lid, at least temporarily, on the growing market expectations for a policy rate hike in mid-2022.

Lastly, tomorrow at 1:30PM, Deputy Governor Larry Schembri will provide further details underlying today's decision. We won't be surprise if his message echoes the prudent approach expressed overnight by [RBA governor Philip Lowe], citing notably weak wage growth and the absence of a rebound in private business investment as reasons to leave monetary policy easing conditions unchanged. Investors should also pay attention to Schembri's speech because he could take the occasion to discuss about - winding down - the Provincial Bond Purchase Program scheduled to end in May. The 1-year program, enacted in May 2020, has served its purpose of maintaining well-functioning provincial funding markets.

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