



Laurentian Bank Securities **ECONOMIC RESEARCH AND STRATEGY**

BoC (July Decision) – No policy rate hike before 2023, even without a second COVID wave

The title of today's statement could not be clearer: the "Bank of Canada will maintain current level of policy rate until inflation objective is achieved". Governor Macklem goes one step further with forward guidance, linking the future path of the policy rate to the 2% inflation target and the absorption of the considerable slack in the economy resulting from the pandemic.

For the Governing Council, the risk is tilted towards deflation/low inflation, not high inflation. Under the central scenario provided in the [Monetary Policy Report](#) (MPR), CPI inflation averages only 0.4% in 2020H2 and accelerates to 1.8% in late 2022. If this central scenario assuming no global widespread wave of COVID-19 turns out to be right, the BoC could be in a position to raise the overnight rate in 2023 at the earliest once inflation is sustainably at the 2% target. In previous business cycles, the BoC started to raise the overnight rate when CPI inflation was accelerating and on its way to 2%. Governor Macklem signals its intention to start hiking possibly at a later stage of this new business cycle, reinforcing the BoC's commitment to keep interest rates low during the recovery. From a long-term perspective, the BoC uses in its central scenario the lower bound of the official nominal neutral rate estimated range of 2.5% to 3.5%. This approach takes into account the scarring effects of the pandemic on business investment, productivity and immigration. While a revision to the neutral policy rate will be provided in the October report, this morning's lower bound usage implies reduced potential economic growth in the long run and restrains the magnitude of future hikes later in the cycle. In the BoC's central scenario, about 40% of the collapse in the first half of the year is made up in 2020Q3. The central bank estimates the 2020Q2 real GDP pullback at 43.0% Q/Q annualized, followed by a 31.3% rebound in 2020Q3, broadly in line with our estimates. Our new base case scenario is similar, assuming that 46% of the recent contraction will be recovered in 2020Q3. In the MPR, real GDP is projected to decline by 7.8% in 2020 before expanding by 5.1% in 2021 and by 3.7% in 2022. Our projections are not materially different. We forecast a 6.5% pullback this year, followed by positive growth rates of 5.4% in 2021 and 2.1% in 2022.

Finally, the BoC did not feel it was necessary to modify the pace and composition of asset purchases: "The Bank is also continuing its quantitative easing (QE) program, with large-scale asset purchases of at least \$5 billion per week of Government of Canada bonds." The provincial bonds purchasing program also remains intact despite growing market talks about the possibility of purchasing long-term provincial bonds. All in all, assets [held by the BoC](#) surpassed the \$500B mark mid-June. Since then, the weekly increase in total assets slowed as the BoC cites the effectiveness of short-term liquidity programs. We note that the amount of BAs, commercial paper and securities purchased under resale agreements held by the BoC has diminished lately.

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