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Macro Market Insights

April 27th, 2019

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Bank of Canada Surprise

Leading into the Bank of Canada's (BoC) interest rate and policy announcement this past Wednesday, expectations were for the Canadian central bank to abandon any guidance of future rate increases. Those expectations were met. The big surprise though was that the Canadian central bank dramatically trimmed their economic growth forecasts for 2019. Following a sobering start to the year, and echoed by private sector economists with calls for the Canadian central bank to move to the sidelines, the Bank of Canada seems to have made explicitly clear they have shifted their policy approach to "wait and see" and have matched the US Federal Reserve in removing any hawkish bias.

The headlines emanating from the bank's statement seemed to be enough to finally see the Canadian dollar give way and break US$0.745. Whereas dollar dynamics have evolved from a relatively stronger US Federal Reserve ahead of other western nations in a path to normalizing interest rates, many FX watchers are beginning to question the return of the commodity currencies (of which the loonie may still be included). As the Bank of Canada's policy approach remains in line with their US counterparts, it seems the greenback may maintain the strength advantage for the time being. But, as analysts at JPMorgan recently noted, when the USD dollar index volatility is this suppressed for this sustained length of time, we've seen on average a 10% price move (both higher and lower) in the index.

From all indications, it does not seem the Canadian central bank will be the contributing factor to future major moves in the Canadian dollar for the time being. What was most noteworthy about Canada's central bank trimming their GDP forecasts is that it implies interest rates may not be moving for the next couple of years. Like the period of July 2015 through to July 2017, overnight interest rates may not change. Most of the reason for this is due to how conservative the Bank's growth forecasts have shifted.

The Bank of Canada is traditionally the most conservative forecaster of the Canadian economy. What was perhaps misinterpreted by some was that they saw the Bank's view shifting to be ultimately bearish. What is more likely though is that this also provides them with downside protection to not have to cut interest rates. One of the major concerns for the BoC during their period of accommodative rates was how household debt levels continued to elevate. Avoiding going back to that scenario, which was a product of lower rates, is certainly at the forefront of their policy discussions.

The final takeaway from Wednesday's announcement is really solidifying a step towards greater clarity. For a central banker that began his tenure without the inclination that every time he publicly spoke his words would be heavily scrutinized, Stephan Poloz has taken great strides towards greater transparency, eliminating what in the past proved to be noise or misdirection. The final reference in the policy statement outlined their focus to household spending, global trade, and oil markets. It would seem paramount, to gather any insight into anticipating future policy changes from the Canadian central bank, that's where investors should focus.