



December 3, 2021 - (Vol. V, No. 130)

Op-ed: For the BoC, promises were made to be broken

By Warren Lovely & Stéfane Marion

Let us be blunt: Having achieved full employment, Canada no longer requires extraordinarily stimulative monetary policy. Indeed, maintaining such a loose policy standing much longer risks compromising Canada's longer-term economic and financial market prospects, jeopardizing this nation's hard-won inflation bona fides.

Our recommendation to the Bank of Canada: Use Wednesday's rate announcement (the final decision for calendar 2021) to telegraph a possible (read needed) normalization of monetary policy in the first quarter of the New Year, implementing the first of multiple interest rate hikes no later than March.

Yes, we're mindful of lingering virus risks. Like others, we're monitoring the situation closely, as the highly infectious omicron variant pops up in more corners of the globe (including here at home). Fresh virus-related restrictions have the potential to (further) impair the outlook for global growth, undercutting support for commodity prices. That's a non-trivial consideration for our still-resource-intensive economy. We're likewise aware that some other forecasters may favour a more becalmed/patient stance when it comes to the onset and pacing of interest rate hikes in Canada. While there's notionally two side to every argument, to us, the case for near-term removal of monetary stimulus is sound.

Say what you want about base effects and snarled supply chains, sky-high inflation – not just in Canada, but in the U.S., across Europe and elsewhere – is impossible to ignore. At least it should be, pursuant to the BoC's *current* monetary policy mandate. We hasten to add that the BoC's existing policy mandate expires December 31st and is thus due to be confirmed any day now. It's telling that the U.S. Federal Reserve is opting to retire the term 'transitory' as it relates to the inflation narrative south of the border. We'll admit to having similar thoughts when it comes to consumer price pressures in Canada, particularly now that our labour market is drum tight.

As ever, we're reticent to over-react to a single bit of data, particularly a series as choppy as Canadian employment. But Friday's jobs report suggests over 150,000 net new jobs were created in November, lifting the six-month employment tally north of 750K. The national unemployment rate is now back down to 6% – a level that would have been considered at or perhaps below NAIRU in pre-COVID days, as per Bank of Canada published research. If there's a constraint to job growth at this point, it's a shortage of workers rather than a dearth of job openings. Think of this as the human capital equivalent of the supply chain pressures we're spending so much time thinking about.

We heard the BoC lamenting labour market 'uncertainties' a few weeks back. Perhaps recent job gains are less-than-ideal. Surely not everyone has participated in the recovery to an equal extent. Still, today's vibrant labour market and record labour force participation for the prime-aged workforce is simply inconsistent with a target policy rate at the effective lower bound of 0.25%, to say nothing of a Bank of Canada balance sheet laden with \$420 billion in Government of Canada bonds.

You may prefer to look past our notoriously choppy jobs data. Perhaps you go in for housing data. Well then, you're likely reading about a reacceleration in activity (constrained only by a lack of properties) and downright steamy price gains in key markets. Maybe fiscal policy is more your jam, in which case you're no doubt aware of marginal stimulus on offer in some provincial capitals, with likely more to come as 2022 elections take shape in some important jurisdictions. Federally, certain extraordinary programs are being walked back, but the minority Liberal government seems intent to funnel every bit of today's revenue gusher right back into the economy. All told, Canada's fiscal impulse is supportive of jobs and growth, arguing for less monetary policy accommodation, all else equal. Turning to the most esoteric data of all, GDP, we've parsed the Q3 national accounts and accompanying revisions to prior periods. Technically, the level of real GDP in this country is no higher than what the BoC had assumed in its October's Monetary Policy Report. To be precise, Q3 output looks to stand 0.2% *below* the Bank's implied forecast. So unlike employment, Canada has yet to stage a full recovery in real GDP. We won't really debate the point.

That brings us to the Bank of Canada's 'conditional commitment' to hold the policy rate at the effective lower bound until the output gap is closed. As recently as late-October, the BoC saw the output gap closing 'sometime in the middle quarters of 2022' (i.e., April to September). If you glanced at Canada's fresh and anemic labour productivity data – it landed alongside Friday's stellar jobs report – you might argue that potential growth has moved down, not up. So Canada's output gap, to the extent there's much of one left, could be closing a bit quicker than previously thought. There's guesswork involved here to be sure. But again, the message from the labour market is that slack is all but non-existent.

The BoC won't treat us to a new economic forecast on Wednesday. We'll need to wait until a January 26th Monetary Policy Report to see how the central bank's view of the world has really evolved. Absent a fresh and definitive read on output gap, it might nonetheless be appropriate for the Bank of Canada to distance itself from the 'conditional commitment' on the policy rate, if only to allow an overdue normalization process to get underway sooner. It's here where promises were made to be broken... or alternatively, where forecasts were made to be revised.

Rate hikes and balance sheet run-off: For a Canadian economy proving so resilient, with jobs so plentiful and inflation so elevated, the time is nigh for demand to be calmed.

Note: National Bank's official interest rate forecast calls for a first BoC rate in Mar-2022, followed by 4 additional hikes over the balance of the year. For 2022, the forecasted end-of-year level for the overnight target rate is 1.5%, which compares to a projected fed funds rate (upper bound) of 1% at the end of next year. We anticipate further normalization, albeit at a reduced rate, in calendar 2023. Complete details will be provided in our upcoming issue of Monthly Fixed Income Monitor.



Economics and Strategy

Montreal Office

514-879-2529

Stéfane Marion

Chief Economist and Strategist
stefane.marion@nbc.ca

Kyle Dahms

Economist
kyle.dahms@nbc.ca

Alexandra Ducharme

Economist
alexandra.ducharme@nbc.ca

Matthieu Arseneau

Deputy Chief Economist
matthieu.arseneau@nbc.ca

Daren King

Economist
daren.king@nbc.ca

Angelo Katsoras

Geopolitical Analyst
angelo.katsoras@nbc.ca

Paul-André Pinsonnault

Senior Economist
paulandre.pinsonnault@nbc.ca

Jocelyn Paquet

Economist
jocelyn.paquet@nbc.ca

Toronto Office

416-869-8598

Warren Lovely

Chief Rates and Public Sector Strategist
warren.lovely@nbc.ca

Taylor Schleich

Rates Strategist
taylor.schleich@nbc.ca

Alpa Atha

Fixed Income Economist
alpa.atha@nbc.ca

General

This Report was prepared by National Bank Financial, Inc. (NBF), (a Canadian investment dealer, member of IIROC), an indirect wholly owned subsidiary of National Bank of Canada. National Bank of Canada is a public company listed on the Toronto Stock Exchange.

The particulars contained herein were obtained from sources which we believe to be reliable but are not guaranteed by us and may be incomplete and may be subject to change without notice. The information is current as of the date of this document. Neither the author nor NBF assumes any obligation to update the information or advise on further developments relating to the topics or securities discussed. The opinions expressed are based upon the author(s) analysis and interpretation of these particulars and are not to be construed as a solicitation or offer to buy or sell the securities mentioned herein, and nothing in this Report constitutes a representation that any investment strategy or recommendation contained herein is suitable or appropriate to a recipient's individual circumstances. In all cases, investors should conduct their own investigation and analysis of such information before taking or omitting to take any action in relation to securities or markets that are analyzed in this Report. The Report alone is not intended to form the basis for an investment decision, or to replace any due diligence or analytical work required by you in making an investment decision.

This Report is for distribution only under such circumstances as may be permitted by applicable law. This Report is not directed at you if NBF or any affiliate distributing this Report is prohibited or restricted by any legislation or regulation in any jurisdiction from making it available to you. You should satisfy yourself before reading it that NBF is permitted to provide this Report to you under relevant legislation and regulations.

National Bank of Canada Financial Markets is a trade name used by National Bank Financial and National Bank of Canada Financial Inc.

Canadian Residents

NBF or its affiliates may engage in any trading strategies described herein for their own account or on a discretionary basis on behalf of certain clients and as market conditions change, may amend or change investment strategy including full and complete divestment. The trading interests of NBF and its affiliates may also be contrary to any opinions expressed in this Report.

NBF or its affiliates often act as financial advisor, agent or underwriter for certain issuers mentioned herein and may receive remuneration for its services. As well NBF and its affiliates and/or their officers, directors, representatives, associates, may have a position in the securities mentioned herein and may make purchases and/or sales of these securities from time to time in the open market or otherwise. NBF and its affiliates may make a market in securities mentioned in this Report. This Report may not be independent of the proprietary interests of NBF and its affiliates.

This Report is not considered a research product under Canadian law and regulation, and consequently is not governed by Canadian rules applicable to the publication and distribution of research Reports, including relevant restrictions or disclosures required to be included in research Reports.

UK Residents

This Report is a marketing document. This Report has not been prepared in accordance with EU legal requirements designed to promote the independence of investment research and it is not subject to any prohibition on dealing ahead of the dissemination of investment research. In respect of the distribution of this Report to UK residents, NBF has approved the contents (including, where necessary, for the purposes of Section 21(1) of the Financial Services and Markets Act 2000). This Report is for information purposes only and does not constitute a personal recommendation, or investment, legal or tax advice. NBF and/or its parent and/or any companies within or affiliates of the National Bank of Canada group and/or any of their directors, officers and employees may have or may have had interests or long or short positions in, and may at any time make purchases and/or sales as principal or agent, or may act or may have acted as market maker in the relevant investments or related investments discussed in this Report, or may act or have acted as investment and/or commercial banker with respect hereto. The value of investments, and the income derived from them, can go down as well as up and you may not get back the amount invested. Past performance is not a guide to future performance. If an investment is denominated in a foreign currency, rates of exchange may have an adverse effect on the value of the investment. Investments which are illiquid may be difficult to sell or realise; it may also be difficult to obtain reliable information about their value or the extent of the risks to which they are exposed. Certain transactions, including those involving futures, swaps, and other derivatives, give rise to substantial risk and are not suitable for all investors. The investments contained in this Report are not available to retail customers and this Report is not for distribution to retail clients (within the meaning of the rules of the Financial Conduct Authority). Persons who are retail clients should not act or rely upon the information in this Report. This Report does not constitute or form part of any offer for sale or subscription of or solicitation of any offer to buy or subscribe for the securities described herein nor shall it or any part of it form the basis of or be relied on in connection with any contract or commitment whatsoever.

This information is only for distribution to Eligible Counterparties and Professional Clients in the United Kingdom within the meaning of the rules of the Financial Conduct Authority. NBF is authorised and regulated by the Financial Conduct Authority and has its registered office at 70 St. Mary Axe, London, EC3A 8BE.

NBF is not authorised by the Prudential Regulation Authority and the Financial Conduct Authority to accept deposits in the United Kingdom.

U.S. Residents

With respect to the distribution of this report in the United States of America, National Bank of Canada Financial Inc. ("NBCFI") which is regulated by the Financial Industry Regulatory Authority (FINRA) and a member of the Securities Investor Protection Corporation (SIPC), an affiliate of NBF, accepts responsibility for its contents, subject to any terms set out above. To make further inquiry related to this report, or to effect any transaction, United States residents should contact their NBCFI registered representative.

This report is not a research report and is intended for Major U.S. Institutional Investors only.

This report is not subject to U.S. independence and disclosure standards applicable to research reports.

HK Residents

With respect to the distribution of this report in Hong Kong by NBC Financial Markets Asia Limited ("NBCFMA") which is licensed by the Securities and Futures Commission ("SFC") to conduct Type 1 (dealing in securities) and Type 3 (leveraged foreign exchange trading) regulated activities, the contents of this report are solely for informational purposes. It has not been approved by, reviewed by, verified by or filed with any regulator in Hong Kong. Nothing herein is a recommendation, advice, offer or solicitation to buy or sell a product or service, nor an official confirmation of any transaction. None of the products issuers, NBCFMA or its affiliates or other persons or entities named herein are obliged to notify you of changes to any information and none of the foregoing assume any loss suffered by you in reliance of such information.

The content of this report may contain information about investment products which are not authorized by SFC for offering to the public in Hong Kong and such information will only be available to, those persons who are Professional Investors (as defined in the Securities and Futures Ordinance of Hong Kong ("SFO")). If you are in any doubt as to your status you should consult a financial adviser or contact us. This material is not meant to be marketing materials and is not intended for public distribution. Please note that neither this material nor the product referred to is authorized for sale by SFC. Please refer to product prospectus for full details.

There may be conflicts of interest relating to NBCFMA or its affiliates' businesses. These activities and interests include potential multiple advisory, transactional and financial and other interests in securities and instruments that may be purchased or sold by NBCFMA or its affiliates, or in other investment vehicles which are managed by NBCFMA or its affiliates that may purchase or sell such securities and instruments.

No other entity within the National Bank of Canada group, including National Bank of Canada and National Bank Financial Inc, is licensed or registered with the SFC. Accordingly, such entities and their employees are not permitted and do not intend to: (i) carry on a business in any regulated activity in Hong Kong; (ii) hold themselves out as carrying on a business in any regulated activity in Hong Kong; or (iii) actively market their services to the Hong Kong public.

Copyright

This Report may not be reproduced in whole or in part, or further distributed or published or referred to in any manner whatsoever, nor may the information, opinions or conclusions contained in it be referred to without in each case the prior express written consent of NBF.