We expect that the Bank of Canada will maintain its overnight rate at 0.75% next week. With no Monetary Policy Report (MPR) or press conference, the decision is expected to simply be a placeholder ahead of the July meeting.

Governor Poloz’s speech this week reiterated many of the themes first introduced in April that will then be repeated again in the May communique.

While we fundamentally do not expect the Bank to cut its overnight rate, the market has moved too far to price out any chance of an ease later this year.

WHEN IN DOUBT, DO NOTHING

Next week’s Fixed Announcement Date (FAD) is expected to be a placeholder ahead of the July decision that will benefit from updated forecasts and greater clarity on some of the acute sources of uncertainty currently clouding the outlook. While higher interest rates and a stronger Canadian dollar has eroded much of the implicit monetary stimulus created following the surprise January cut, the emergent stability and subsequent rally in the price of oil has eliminated the need for a proactive shift in tone. Moreover, the outlook for the US economy beyond the Q1 soft patch and its ability to support Canadian non-energy exports has yet to be revealed and augurs for greater patience.

The communique accompanying the FAD is therefore expected to reiterate many of the familiar themes presented both at the April FAD and in Governor Poloz’s speech earlier this week. This expectation is aligned with our fundamental view that the Bank will hold its overnight rate unchanged at 75bps but we continue to believe that the market has not priced in a high enough probability that the Bank could ease if the growth narrative does not unfold as expected.

Oil Buys Time for the Bank

Despite the overarching theme of uncertainty, the relative calm that has returned to the price of oil (averaging between $8-14/bbl higher than the April Monetary Policy Report (MPR) assumption) and other financial market variables has allowed the Bank of Canada to revert to a more reactionary mode. As a result, monetary policy will be driven more by the slow moving developments in the economy than changes in financial conditions:

- At the top of the list is the hit to the economy from lower oil prices. Our current tracking for Q1 real GDP growth is an annualized 0.5% increase which is in the ballpark of the Bank’s forecast for a flat print. With limited data to challenge the view, the Bank continues to believe that the oil price shock has come sooner and is not necessarily larger than originally anticipated.

- The more significant source uncertainty is the ability of the US economy to bounce back in Q2 and if Canadian non-energy exports will keep pace. We have sympathy with the argument that it remains too soon to gauge the health of the US economy based on just a smattering of April data. On this front, domestic data has generally held up better than export-orientated data. And while the recent appreciation in the Canadian dollar—which has averaged 3.5 US cents higher than what was incorporated into the April MPR—is a clear headwind, the Bank sees no urgency to respond.

In his speech earlier this week, Governor Poloz also reiterated many of the longer-term macro views presented in the April MPR.

Financial Market Dashboard

![Financial Market Dashboard](image)
Of note, the Canadian economy is still expected to return to full capacity by the end of 2016. The concern over the persistence in core inflation—which has remained above the 2% target since July 2014—was also dismissed as a function of temporary and transitory influences. By contrast, the Bank currently estimates that underlying inflation is running at a far more benign rate of between 1.6 and 1.8%. With little perceived risk from inflation and no apparent willingness to wade into the household imbalances debate, the path of least resistance is for the Bank to maintain its core views in the May communique.

A Sunny Poloz Makes it Harder to Shade the Balance of Risk
Assessing the balance of risk around what is expected to be an uneventful FAD is a difficult proposition. Based on the muted market reaction to Poloz’s speech this week, it appears that the Bank’s newfound optimism is fully priced in. The lack of urgency to respond to the downside risk posed either by the uncertainty surrounding the US outlook or the appreciation in the currency and increase in bond yields will do little to drive market sentiment next week.

Over a longer horizon we remain of the view that the Bank is too optimistic on the expected rebound in Q2 and beyond. Exacerbated by financial market developments, the lurking downside risk to the Bank’s outlook makes it difficult to credibly justify an incrementally more optimistic shift in tone. While more patience is clearly required—it may very well take until July—we continue to believe that pricing in a more dovish Bank of Canada is a matter of when and not if.

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