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Special Edition Canada Outlook:

Bank of Canada cuts rates, starts quantitative easing

Key takeaways

- The Bank of Canada lowered its target for the overnight rate by 50 basis points to 0.25%. This unscheduled rate decision was the third rate cut in March.
- We do not expect the Bank of Canada to cut its overnight rate into negative territory.
- The Bank also announced a minimum $5-billion-per-week in market purchases of Government of Canada bonds. This marks the first time the Bank has engaged in quantitative easing.
- The Bank of Canada's aggressive action, along with its commitment to do more if conditions worsen, is a constructive sign for the market.
- On the fiscal policy side, the government of Canada has committed to a range of economic supports as part of an $82-billion COVID-19 economic response plan. This support represents more than 3% of Canada's GDP.

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Bank of Canada cuts interest rates and injects liquidity to support financial system

On March 27, the Bank of Canada lowered its target for the overnight rate by 50 basis points to 0.25% in its ongoing response to the COVID-19 outbreak. This unscheduled rate decision was the third rate cut in March. This level represents the Bank's idea of the "effective lower bound."

We do not expect the Bank of Canada to cut its overnight rate into negative territory consistent with Governor Poloz's recent messaging. The Bank of Canada, along with the Department of Finance and OSFI, maintain a wide assortment of policy tools to combat the headwinds facing the Canadian economy. Therefore, we see a negative policy rate as one of the last policy tools the Bank would use to add stimulus to the Canadian economy.

Financial institutions deposit their excess cash at central banks for safekeeping, where they earn a small return on those funds. But in a negative rate environment, the banks get charged by the central bank for storing dollars.

The Bank announced two new programs to support liquidity

The first program commits the Bank to purchase commercial paper issued by Canadian corporations, municipalities and provinces. This program is expected to increase liquidity and support the flow of credit to large Canadian firms.

The Bank also announced a minimum $5-billion-per-week in market purchases of Government of Canada bonds, "to address strains in the Government of Canada debt market and to enhance the effectiveness of all other actions taken so far."

Quantitative easing designed to support market liquidity

This marks the first time the Bank has engaged in quantitative easing, which involves the Bank purchasing longer-term securities on the open market to boost the money supply and encourage lending and investment.

Quantitative easing will lead to a reduction of net supply of Government of Canada bonds. The Bank has committed to keeping the program in place "until the economic recovery is well underway." The Bank could expand this program to other types of debt if the economic recovery from COVID-19 does not start in the near future.

Canada is facing deteriorating economic conditions, with rising unemployment claims in response to the COVID-19 crisis and associated quarantines as well as a plunge in oil prices. The Bank of Canada's aggressive action, along with its commitment to do more if conditions worsen, is a constructive sign for the market as central banks continue to aggressively add stimulus to financial markets.

Government spending working in tandem with rate cuts to support markets and the economy

On the fiscal policy side, the government of Canada has committed to a range of economic supports as part of an $82-billion COVID-19 economic response plan. This support represents more than 3% of Canada's GDP. The plan will provide up to $27 billion in direct support to Canadian workers and businesses, plus $55 billion to meet the liquidity needs of Canadian businesses and households through tax deferrals to help stabilize the economy.

Adapting to a volatile environment

The markets have faced an indiscriminate sell-off as COVID-19 spreads globally. Economic indicators in the next few months are going to be extremely negative and reflect the temporary reality that we are in. But it’s important to remember that economic indicators are always a rear-view picture and that markets have a tendency to lead the economy by six to nine months.

“Diversification remains key. Our portfolios are diversified in bonds and currencies that are mitigating the impact of the correction.”

Diversification and focusing long term are key to getting through this crisis

Diversification remains key. Our portfolios are diversified in bonds and currencies that are mitigating the impact of the correction. History suggests that panicked sellers will likely be losers, because they end up selling low and buying high. Selling and parking cash on the side-lines might seem like a good plan, but timing re-entry into market is extremely difficult.

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