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The Bigger Picture

A weekly snapshot of the markets

Issue No. 289
March 2, 2015

Odds of another Bank of Canada rate cut on March 4 sharply reduced

But most economists expect BoC will cut rate by 25 basis points later this year

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In recent years, economists and market participants were almost always unanimous about the Bank of Canada's interest rate moves ahead of its rate announcement. And in most cases, the BoC obliged by sticking to the script. But that unanimity about the Bank's next rate move has diminished this year, as BoC Governor Stephen Poloz has traders and investors guessing after catching market participants by surprise on two separate occasions over the past 1½ months.

Poloz's first surprise was an unexpected rate cut on January 21, when the Bank of Canada cut its overnight rate by 0.25 percentage point to 0.75%. The Bank justified its rate decision – which was not predicted by any of the 19 economists surveyed by Bloomberg – by stating that its rate cut was in response to the recent sharp drop in oil prices, which would be negative for growth and underlying inflation in Canada. The Canadian dollar promptly sank to a six-year low of 78.18 U.S. cents by January 30, based on a growing consensus that the BoC would cut rates again on March 4.

But on February 24, Poloz delivered another surprise when he suggested during a speech at Western University that the January rate reduction may be enough for now. Specifically, he noted that the "downside risk insurance" from the rate cut buys the BoC some time to see how the Canadian economy actually responds.

As a result, the probability of a second rate cut on March 4 futures market – based on futures market pricing – had diminished from as much as 80% to less than 30% by Friday. In addition, only four economists of the 19 surveyed by Bloomberg expect the overnight rate to be slashed by 25 basis points (to 0.50%) on March 4.

However, most economists expect the Bank of Canada to cut the overnight rate to 0.5% by mid-year. We share this view, based on the fact that the impact of the 50% plunge in crude oil prices on the Canadian economy has yet to be felt.

A report earlier today showed that the RBC Canadian Manufacturing PMI dropped from 51.0 in January to 48.7 in February, signalling a moderate deterioration in overall business conditions across the manufacturing sector in Canada. The February reading ended a 21-month period of sustained expansion and was the lowest level since the survey commenced in October 2010. Another report showed that Canadian consumer confidence declined last week to the lowest level in almost two years.

Bank earnings released over the past couple of weeks have alleviated investors' concerns about the outlook for the Canadian economy to a significant extent, and as a result, the TSX is trading well above 15,000 (Chart below). The Chart also shows the close correlation between crude oil and the Canadian dollar, the takeaway here being that the lower loonie has offset some of the damage wrought by the oil price plunge. While crude oil (WTI) has managed to find support around the $50 level, it remains to be seen whether this support level proves to be the proverbial "line in the sand." If it does not, and crude oil resumes its downtrend, there could possibly be more than one more rate cut from the Bank of Canada in store this year.

TSX and Crude oil (WTI 1st month futures) vs. spot C$

Source: Bloomberg

Market Snapshot

At Close today

S&P TSX	15264.05	+29.71	Commodities			Yields (%)	Can.	US
TSX Venture	704.30	-2.43	Canadian $ (US cents)	79.76	-0.20	90 Day T-Bill	0.55	0.01
DJIA	18288.63	+155.93	Gold (Spot)-US$	1206.83	-6.39	2-Year Bond	0.49	0.66
S&P 500	2117.39	+12.89	Oil (WTI-Apr.)	49.59	-0.17	10-Yr.Bond	1.37	2.08
NASDAQ	5008.10	+44.57	CRB Index	221.98	-2.10	30-Yr. Bond	1.98	2.68

Thought for the Day

"The most important thing in communication is hearing what isn't said."
– Peter Drucker

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