

# Bank of Canada Rate Alert

## Bank of Canada expected to cut as Covid-19 drags on economy

**Update March 3, 2020:** *The U.S. Fed surprised the market this morning with an emergency rate cut of 50 bps, cutting the target for the federal funds rate to a range of 1 – 1.25 per cent in light of coronavirus risks. The move is likely geared at soothing consumer and business sentiment, with lift to the real economy modest.*

This likely guarantees a cut to the Bank of Canada's target overnight on Wednesday March 4 from 1.75 per cent to 1.50 per cent in response to a hit to the global economy from Covid-19 and as part of a broader response from major central banks and governments around the world to shore up the economy. The question is magnitude of the cut, and if the Bank follows the Fed. Futures market expect the Bank of Canada to cut by 25 bps. OIS futures are pricing in a 100 per cent probability of a 25 bps in March and another cut in April to 1.25 per cent.

The Bank of Canada's decision will come amidst a backdrop of economic and market disruption related to Covid-19. Last week the Dow Jones tumbled 12 per cent and S&P/TSX fell nearly 9 per cent. WTI oil fell 16 per cent to about \$45 to the lowest level since late- 2018. 10-year yields plunged, with U.S. yields down 30 bps to 1.14 per cent, with Canada down 13 bps to 1.13 per cent. Equities have rebounded as markets have responded to likely central bank support.

Chinese manufacturing plunged in February according to the latest official PMI measures, confirming a sharp slowdown in the region following lockdowns in the country. Consumer demand and global travel has declined while supply chains are being interrupted. An accelerating spread of the virus to other countries likely signals a viral pandemic which will further slow the economy in Q1/Q2 as more countries take added precautions to stem the spread. February's global manufacturing PMI pointed to a sharp contraction in activity led by China. Negative impacts on Canada's sluggish economy in Q1 are further exacerbated by recent protest rail blockades.

In our view policy rate cuts will do little to stoke economic growth given the limited response of consumers amidst viral fears and supply chain disruptions. However, it will signal that policy makers are acting and ease market fears.

We expect a stronger rebound in the economy in late Q2 as pandemic fears ease and a backfill of economic activity lifts growth during H2. Reversal of rate cuts would likely ensue. There is a risk that the pandemic will persist for a longer period, driving a deeper downturn in the economy and contributing to further rate cuts.

Our call:

The Bank of Canada cuts to 1.50 per cent at its March 4 meeting. A further cut is expected on April 15 but dependent on spread of the virus. The policy rate is hiked in late 2020. The Fed's sharp cut this morning increases the chance of a more aggressive response by the Bank of Canada tomorrow.

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