

Bank of Canada Rate Alert

Highlights

- More emergency measures by the Fed; policy rate cut to the zero-lower bound
- Bank of Canada to follow with cut to 0.25 per cent
- Sharp economic fallout from coronavirus and oil price war

The U.S. Federal Reserve (Fed) on Sunday March 15, 2020 announced a sweeping set of moves to counter the sharp economic downturn caused by coronavirus containment measures on the U.S. economy and in many other countries. The Fed cut its policy rate one full percentage point to a range of 0.0 to 0.25 per cent and will buy \$700 billion in Treasury and mortgage-backed securities along with eliminating bank reserve requirements and lowering the cost of using its discount window. The goal is to lower the cost of credit and support the flow of credit to households and businesses in order to stimulate economic activity.

This is the second, and unprecedented, emergency rate cut by the Fed in two weeks, which took its policy rate down 150 basis points (bps). The Fed's statement said it would hold rates at the new, low level "until it is confident that the economy has weathered recent events and is on track to achieve its maximum employment and price stability goals."

The coronavirus pandemic has caused the implementation of a variety of containment measures designed to reduce and minimize person-to-person interactions. Travel and movement restrictions, public event and meeting cancellations, school closures, country lockdowns, and 'social distancing' are disrupting economic activity at a rapid pace. The virus outbreak will weigh heavily on activity in March, April, and into May. This disruption is expected to be large, though not long. A quick bounce-back will occur when the all-clear is given.

In light of the Fed's Sunday move, the Bank of Canada will follow with another rate cut to 0.25 per cent or 50 bps in the very near future, probably this week. Waiting until its next regular rate announcement meeting on April 15, 2020 will be seen as not using its full weight to counteract this serious economic downturn.

Canada's economy is straining under the double hit of coronavirus containment measures and the large drop in oil prices. Growth in first quarter 2020 real output will be close to zero and possibly negative, with second quarter real output falling at a three per cent annual rate or more. Another output contraction in Canada during the third quarter of 2020 is very possible depending on the spread of the virus.

The coronavirus epidemiological or 'epi' curve in Canada, the U.S., Europe, and elsewhere is in the acceleration phase unlike in China and South Korea where their epi curves are in the deceleration phase. Additional measures will be announced and implemented this week by governments and businesses.

To the extent that containment measures flatten the epi curve, their economic impacts will be spread out longer and with less health impact on the population. The longer containment measures remain in place, the greater the negative economic impact. When the deceleration phase of the epi

curve emerges, hopefully in the next two or three months, containment measures will be eased and eventually lifted.

The Bank of Canada rate cuts and credit measures along with upcoming fiscal stimulus will help to mitigate the downturn and set the stage for the eventual rebound and future growth. Lower oil prices are good for consumers and should provide a boost as well, though when the oil price war will end is less predictable. A sharp rebound in economic activity is expected when the all-clear is given and these emergency rate cuts will be reversed sometime thereafter.

A fuller interest rate outlook will be available shortly in the *Interest Rate Forecast* report.

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