# Monetary Policy Report, the Overnight Rate Held Steady; COVID-19 Uncertainty Remains

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## Bottom Line

This week we are reviewing the Bank of Canada (BoC)'s policy rate decision and its October 2020 Monetary Policy Report (MPR); both released Octobers 28, 2020.

The overnight rate was kept at a ¼ per cent. The BoC has conditionally committed to keeping it low, so it is likely to remain low for the foreseeable future.

With the COVID-19 pandemic and reactions to it acting as a global drag on economic activity, growth in potential output is expected to be lower in 2020, with the possibility of lower growth into the 2020 – 2022 projection period.

High-contact service industries are experiencing weakness across the globe, as adapting supply and demand is more difficult than goods producing or low-contact services. A knock-on effect has reduced demand for oil and gas.

Even low-contact industries have experienced slowing productivity and potential output. Why?

- In areas with high-speed internet (HSI), many have been able to work from home effortlessly, although with some productivity loss. Childcare has been an issue as well.
- In areas where HSI is not widely available, this has meant that fewer professionals have been able to work from home as productively (or at all). This is in addition to childcare issues.

While uncertainty is much lower than prior to the pandemic lockdowns, uncertainty remains high due to the pandemic and its global effects. Rising case counts are expected to weigh on economic activity due to additional actions needed to bring those case counts down. The MPR gives us a few added points to consider and watch as we continue dealing with COVID-19 here in Manitoba.

## Analysis

On October 28, 2020, the Bank of Canada (BoC) released its policy rate decision and released the October 2020 Monetary Policy Report (MPR). The overnight rate was kept at ¼ per cent. The October 2020 MPR explains the reasoning behind the decision.

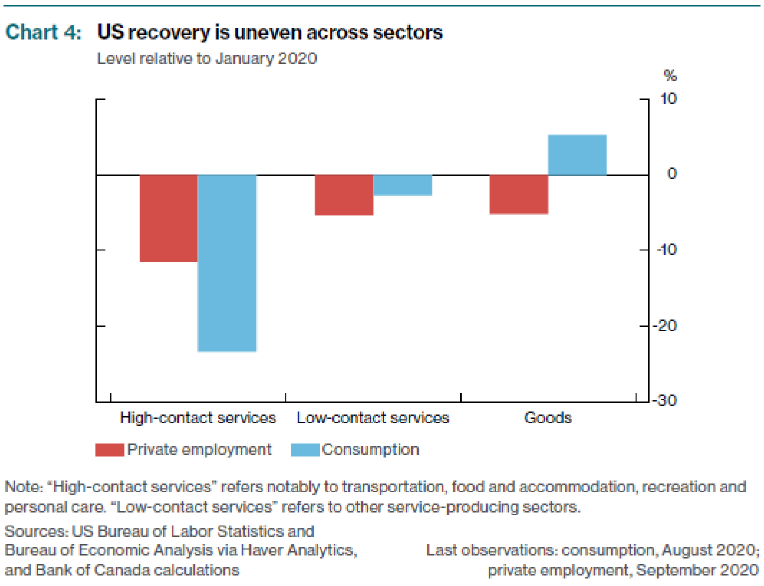
The BoC's projection depend crucially on assumptions about the COVID-19 pandemic. Specifically, they assume:

- "*Extensive lockdown measures, such as the widespread closures imposed early in the pandemic, will not be reintroduced, although more localized and moderate containment measures will ebb and flow.*
- *Vaccines and effective treatments will be widely available by mid-2022, at which time the direct effects of the pandemic on economic activity will have ended. Precautionary behaviour of households and the effects from the uncertainty surrounding COVID-19 are, however, likely to linger.*" [1]

The BoC also raises concerns about the possibility of lingering, dampening effects on **potential output** in Canada.[2]

## Global Economy

*Figure 1: US recovery is uneven across sectors - Source: BoC MPR*




The BoC laid-out its assumption about the global economy. **Table 1** below show how their GDP growth assumptions have changed by geography since the July 2020 MPR. GDP growth in 2020 was revised upward on better-than-expected growth the past few months. The exceptions are countries grouped together as oil-importing emerging-market economies (EMEs)' are expected to fall more in the October projection vs the July projection.

For most country groupings, the projection for both 2021 and 2022 is lower than the July projection. This is due to weaker prospects for EMEs, and downward revisions to **potential output** growth, affecting all economies, with the details varying by country. Each country has their own policy and general population approaches to the COVID-19 pandemic.

[1] Quoted from page 2 of the Bank of Canada (October 2020) Monetary Policy Report.

[2] Potential output is not something most people talk about on a daily basis. The Bank of Canada's staff analytical note "Potential output in Canada: 2020 reassessment" is well worth reviewing, particularly by policy makers and influencers. The note discusses the relevant factors affecting potential output, focused on Canada.

*Table 1: Bank of Canada's Projection for Global Economic Growth*

| Grouping | Share of real global GDP (%) /1 | Projected growth (%) /2 | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | 2019 | | | 2020 | | | 2021 | | | 2022 | | |
| | | Jul | **Oct** | Δ | Jul | **Oct** | Δ | Jul | **Oct** | Δ | Jul | **Oct** | Δ |
| United States | 16 | 2.3 | **2.2** | -0.1 | -8.1 | **-3.6** | 4.5 | 3.4 | **3.1** | -0.3 | 4.3 | **3.4** | -0.9 |
| Euro Area | 12 | 1.2 | **1.3** | 0.1 | -9.3 | **-8.0** | 1.3 | 4.2 | **4.9** | 0.7 | 3.6 | **2.4** | -1.2 |
| Japan | 4 | 0.7 | **0.7** | 0.0 | -6.1 | **-5.7** | 0.4 | 3.8 | **3.7** | -0.1 | 2.6 | **1.9** | -0.7 |
| China | 17 | 6.1 | **6.2** | 0.1 | -0.3 | **1.6** | 1.9 | 8.8 | **8.2** | -0.6 | 6.3 | **5.5** | -0.8 |
| Oil-importing EMEs /3 | 34 | 3.1 | **3.0** | -0.1 | -4.8 | **-5.6** | -0.8 | 5.8 | **5.3** | -0.5 | 6.1 | **6.0** | -0.1 |
| Rest of the world /4 | 17 | 1.3 | **1.3** | 0.0 | -6.9 | **-5.0** | 1.9 | 2.2 | **1.0** | -1.2 | 6.1 | **2.5** | -3.6 |
| World | 100 | 2.9 | **2.8** | -0.1 | -5.2 | **-4.0** | 1.2 | 5.2 | **4.8** | -0.4 | 5.4 | **4.3** | -1.1 |

Source: Bank of Canada, Monetary Policy Report, October 2020, Page 4.

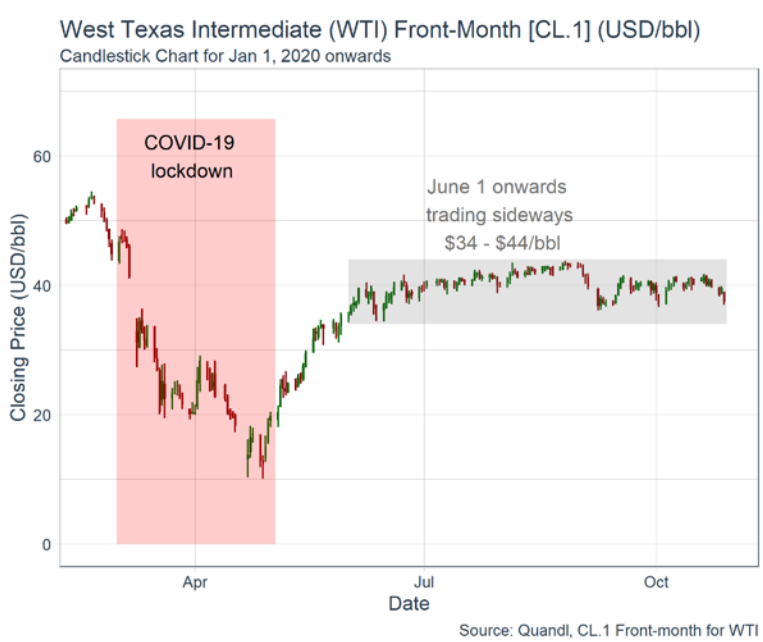
/1 GDP shares are based on International Monetary Fund (IMF) estimates of the purchasing-power-parity valuation of country GDPs for 2019 from the IMF's October 2020 World Economic Outlook.

/2 EDW reformated the table to three columns to show July, October and the change between the two forecast periods.

/3 The oil-importing emerging-market economies (EMEs) grouping excludes China. It is composed of large EMEs from Asia, Latin America, the Middle East and Africa (such as India, Brazil and South Afica), as well as newly industrialized economies (such as South Korea).

/4 "Rest of the world" is a grouping of all other economies not included in the first five regions. It is composed of oil-exporting EMEs (such as Russia, Nigeria and Saudi Arabia) and other advanced economies (such as Canada, the United Kingdom and Australia).

*Figure 2: WTI (US$/bbl)*




**High-contact service industries** [3] have been the most negatively affected in the USA, as measured by employment and consumption (**Figure 1** above). While the degree of effect varies across all countries, negative effects are typically evident in these industries, even if other industries are less affected.

As noted in Box 1 of the October MPR, Global Value Chains (GVCs) have adapted quickly, contributing materially to the rebound in global trade and economic activity. They

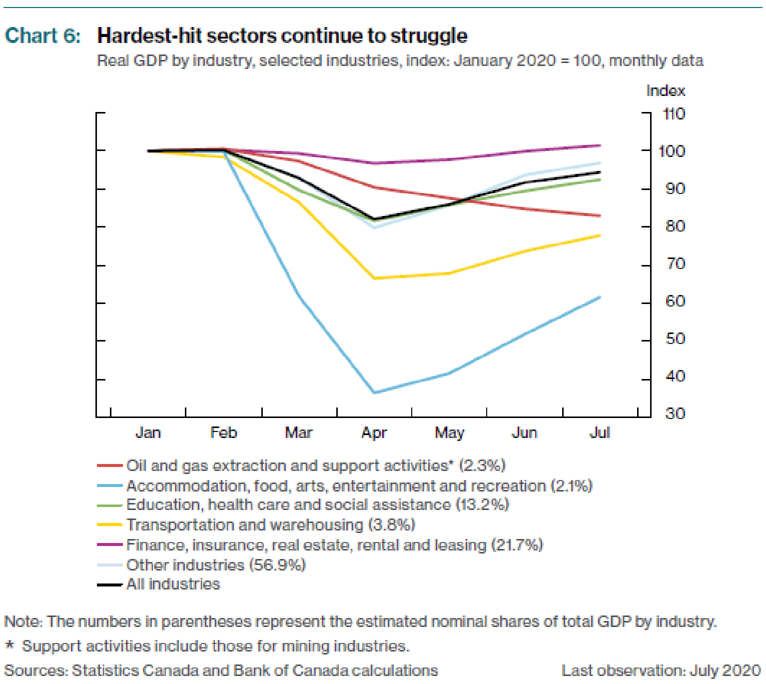
[3] High-contact industries refer to transportation, food and accommodation, recreation and personal care.

also noted that sectors with strong linkages to international trade, such as manufacturing, are less affected by the COVID-19 pandemic.[4]

Commodity prices have recovered (base metals, agricultural products, and forestry products), with a glaring exception. Crude oil prices are still weak; West Texas Intermediate (WTI) remains locked in the channel of US$34 - 44/bbl, with the front-month closing at US$37.39/bbl on October 28 (**Figure 2** above). Continued demand weakness from air transportation (*particularly*), along with ground transportation (*less need to commute with many still working from home*) has played a role in keeping prices weak.

## Canadian Economy

*Figure 3: Hardest-hit sectors continue to struggle. Source BoC MPR*




As we noted in issue 34 of the Weekly Economic Digest (WED), there is divergence in the speed of recovery of the various economic sectors (**Figure 3**).

1. **Oil and gas extraction and support activities** have continued sliding since February 2020, dragged down by the severe decline in support activities (lower drilling, minimal service work).

2. **Transportation and warehousing** remain down, due to weakness in:
    a. **transit, ground passenger, scenic and sightseeing transportation** (y/y index of 46), and
    b. **Air transportation** (y/y index of 8).
3. **Accommodation, food, arts, entertainment, and recreation**. This sector is suffering from widespread weakness.

Not surprisingly, this is showing up as a shift in consumption patterns. The BoC noted that consumption patterns have shifted because of the pandemic or due to reactions to the pandemic (**Figure 4**).

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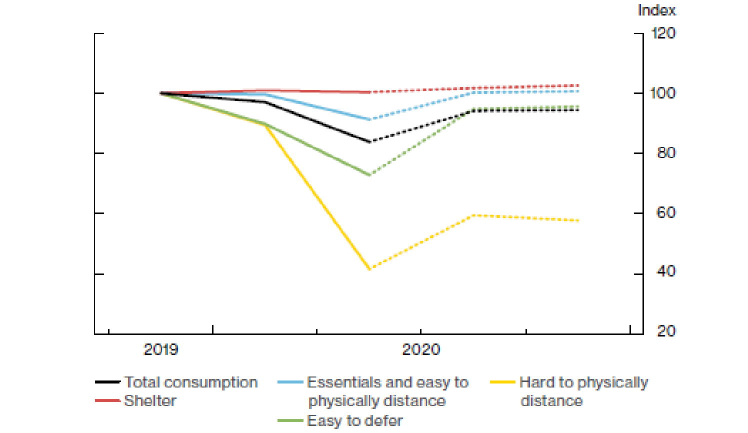
[4] For firms less tied to GVCs, at least some of these lessons may be transferable from those more deeply connected to GVC. Even the smallest firm can learn to be more resilient, able to pivot more quickly. Having ready access to capital will surely be part of the solution going forward.

*Figure 4: Consumption patterns have shifted - Source BoC MPR*

**Chart 8: Consumption patterns have shifted**

Nominal and seasonally adjusted consumption, index: 2019Q4 = 100, quarterly data




Note: "Essentials and easy to physically distance" includes spending on categories such as groceries, alcohol, clothing, footwear and medical products as well as health, education, communication, insurance and financial services. "Hard to physically distance" includes spending on categories such as food and beverages in bars and restaurants, accommodation, recreational, cultural and transportation services as well as travel expenditures by Canadians abroad. "Shelter" includes spending on categories related to the ownership, rental or maintenance of a dwelling. "Easy to defer" includes spending on categories such as vehicles, appliances, furnishings and jewelry.

Sources: Statistics Canada and Bank of Canada estimates and calculations Last data plotted: 2020Q4

Consumption where it is hard to physically distance remains significantly below January 2020 levels. Most other sectors are much closer to recovery.

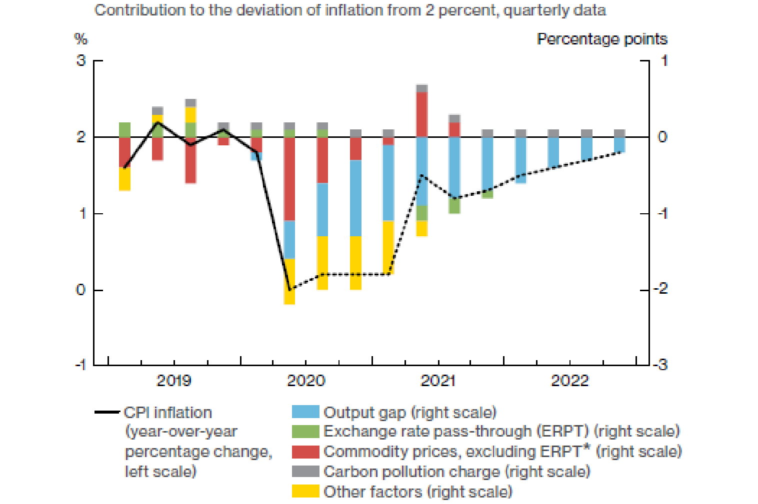
As we noted in [WED issue # 36], this continues to affect the labour market in a differential manner. The BoC has made note of this as well.

Canadian's have also boosted their precautionary savings at this time. The BoC projects that this will slowly return to the average pre-pandemic level by the end of the 2022.

*Figure 5: Inflation to rise gradually as economic slack is absorbed. Source: BoC MPR*

**Chart 17: Inflation to rise gradually as economic slack is absorbed**

Contribution to the deviation of inflation from 2 percent, quarterly data




Note: Numbers may not add to total because of rounding.

* This also includes the effect on inflation of the divergence from the typical relationship between gasoline and crude oil prices.

Sources: Statistics Canada and Bank of Canada estimates, calculations and projections

Given the large uncertainty, the BoC projects non-oil business investment will remain low until mid-2022. They see low oil and gas business investment, given their assumption of crude oil staying around US$40 throughout the projection period.

This implies significant slack in the economy, putting downward pressure on inflation. The output gap is expected to exist until late in 2022 (**Figure 5**). The BoC's risks to the inflation forecast are noted as the following: [5]

[5] Since the BoC's inflation rule is to return inflation to two per cent, within a control range of 1 to 3 per cent, they have a symmetrical need to encourage inflation to rise when it is too low, or fall when it is too high.

**Inflation Upside Risks:**

- Added US fiscal stimulus (not forecast for 2020)
- Stronger household spending in Canada

**Inflation Downside Risks:**

- If there were a sharp tightening of global financial conditions,
- If there was rising household and corporate financial stress.

The October 2020 MPR gives us the contours of how the BoC sees economic activity and the COVID-19 pandemic evolving. The risks outlined above will bear watching while we work to keep COVID-19 under control on the way to a vaccine. As we had noted way back in WED # 11 (May 1, 2020, Figure 2), we need to keep our COVID-19 case counts at any one time between the tolerability imperative and medical imperative.

With Friday's announcement of 480 cases of COVID-19, we note the following. Manitobans, particularly in the Winnipeg Metropolitan Region, need to reach out to friends and family, but in a way that meets public health guidelines. That may mean calling people up using the phone, or making video calls. This will be good for our mental and physical health.

When we do need to wear masks, we need to wear them properly, and follow other public health guidelines. **Getting the fundamentals right should see the situation improve over time. Controlling the COVID-19 outbreak is key to economic recovery, while we wait for vaccines to be available. Let's get it done.**

EDW Contacts for Assistance or Inquiries:

- **For Winnipeg businesses looking for help accessing government programs, please reach out to our Yes! Winnipeg Team** through our Help us help you form if you are not sure who to contact on the Y!W team.
- For general inquires please email wpginfo@edwinnipeg.com.
- For Marketing & Communications Inquiries, please email marketingandbranding@edwinnipeg.com.