Inflating BoC Expectations Transcript

Ben Reitzes:

Welcome to the Ninth Episode of Views From the North, a Canadian rates and macro podcast. This week, I'm joined by BMO's Hong Kong-based trader, Dave Moore. Dave trades various Canadian dollar and U.S. dollar bonds during the Asian session. This week's episode is titled, Inflating Bank of Canada Expectations.

I'm Ben Reitzes, and welcome to Views From the North. Each episode, I will be joined by members of BMO's FIC Sales and Trading Desk to bring you perspectives on the Canadian rates market and the macro economy. We strive to keep this show as interactive as possible by responding directly to questions submitted by our listeners and clients. We value your feedback, so please don't hesitate to reach out with any topics you'd like to hear about. I can be found on Bloomberg or via email at benjamin.reitzes@bmo.com. That's Benjamin dot R-E-I-T-Z-E-S@B-M-O.com. Your input is valued and greatly appreciated.

Speaker 1:

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Ben Reitzes:

It's been a few months since I had Dave on the show, and a lot has changed since then. It's been a particularly eventful couple of weeks in Canada with the Bank of Canada's policy announcement and the changes to their securities repo operation. Dave last joined me on October 7th. And on that day, Canada 10-year yields closed at 62.4 basis points, and U.S. 10-year yields closed at 78.5 basis points. He made his bearish view on duration well known that day, and here we are more than 20 basis points higher in yield. Great call, Dave. Welcome to the show.

Dave Moore:

Thanks for having me. That was just better lucky than good, honestly. I look at what's changed, and a lot of it has played out as we spoke about, prediction of faster recovery, prediction of getting vaccines into people's hands faster than was being priced in, the general steepening that comes with quicker recoveries. The 5s30s curve, I think is probably 20 beeps steeper, and that's not even at the steeps since we spoke. Thirty year yields are 35 beeps higher and 5-year/5-year inflation, 30 beeps higher, 10-year breaks are probably 40 odd beeps. So a lot has happened. And yeah, okay, I got lucky on a call and said that I think that 30 years are no man's land. But that hasn't changed. I still feel that's the case that I cannot justify owning long bonds, even here, even after a 20 basis point or a 30 basis point move.

I don't sit here and get excited at the prospect of long bonds here, and I just don't see that changing any time soon. And so I will remain in that perma-bear camp unless things change and the information in front of me changes. But for now, that hasn't been the case, so I'm still there and I do think the Bank of Canada is one of the most interesting things that's going on since we last spoke.

Ben Reitzes:

All right. I agree your broader view still, as our listeners know well. This week we're going to tackle some big questions that are or will be hanging over the Canadian market. For example, what is the outlook for inflation in Canada? How will that impact the demand for duration? Will the Bank of Canada be a first mover among central banks and U.S.-Canada relations in the context of the Keystone XL cancellation and what the Biden administration could mean for the Canadian macro landscape? But before we get onto those topics, I'm going to talk about the Bank of Canada a little bit first. Last week's policy announcement, I mean, pretty much as expected. There were some rumblings of a micro cut. That didn't come. I still say that would have been awful tough to explain given the better backdrop. They managed to keep their timing for the output gap closing the same.

But, I mean, I think that was to some extent, I'm not going to say fudged, but that probably took some effort to keep it in 2023. As with the U.S. output gap now closing in 2021, the vaccine timeline has improved notably. Fair that Q1 this year that we're currently in is going to be materially weaker than everybody thought, and there's probably downside risk to most forecasts. But the rebound is still very much in play once we get vaccinations moving a little bit quicker than they are now, which I'd expect probably at least over the next few months or so. The other big news out of the Bank was on Friday, late Friday, they expanded the securities repo operation, and for those who aren't very avid front end watchers, the front end of Canada has seen notable shortages of collateral and that that's pushed CORRA, the repo rate effectively, down pretty significantly below target.

Historically, CORRA sets around the Bank of Canada's policy rate. It has been drifting down for a while. It was setting at 20 versus 25 for a long time, and then last week, just ahead of the bank, it fell into the mid-teens and that caused a bit of a tizzy in the market. And then that's driven by a couple of factors. Again, a shortage of collateral. The Bank of Canada keeps buying a lot of bonds. There just aren't enough bonds out there in the market to satisfy demand and so that drives them to be special in repo. And the second half of the equation there is just cash piles. I mean, the banks and the financial system have a massive stockpile of cash driven by QE, term repo operations, everything the Bank of Canada has done over the past year. All their extraordinary measures have really pushed cash into the market, and so that cash needs to find a home. Tends to be in the front end and so that exacerbates all of these problems.

And so what the Bank of Canada has done is they've made the bond that they bought more available to be borrowed by the financial system, generally by banks and such. And so that helps ease that shortage of collateral. We've seen some increase in CORRA already. One day in, it rose five basis points from 15 bps to 20 bps, so it seems as though that's mission accomplished for now. One of the questions that I've gotten, and I think the commentary I've seen from a number of people is, why did they wait till Friday? And some folks are viewing this as a quasi-rate hike, a stealth hike. And I mean, put both of those thoughts to bed, please. One, this move is meant to be totally separate from policy, and they've done that on purpose. QE is an effort by the Bank of Canada to provide as much stimulus as possible in difficult times. And the market impact is secondary there.

I mean, they want the market to function properly, but that's a secondary impact and they'll deal with that separately. That has nothing to do with providing stimulus. And so they want the market to function properly, and when you have a shortage of collateral and that has other market impacts, like pulling CORRA down, that's something they look to alleviate over time. And so, I mean, that's what's driving this. Don't think about this move in any way is related to policy. It's intended to allow proper market functioning rather than be any type of policy move. So please, please put that thinking at the bed for now. We'll see if things change, but that's how I view this. Dave, before we move on to those questions, any thoughts on the bank before we get to that first inflation question?

Dave Moore:

Yeah, I totally agree. When I look at, why'd you do it on a Friday and not at the meeting that just happened to be a couple of days before? As they were very deliberate in saying that this is not part of the standard rate decision process, that this is a tool that is used in times of crisis and can be called on at any moment in time. And I think that's proper. I think it's appropriate. I don't see it as a stealth hike. I don't see it as any of those things. I think it's market stabilization, financial stability measures being done in a prudent way. Whether CORRA stays at 20 beeps or not is up for discussion, and I think that there will be further gyrations in CORRA, because that's what happens when you own 37%, 39% of Canadian?

Ben Reitzes:

Yep.

Dave Moore:

Somewhere around there, right?

Ben Reitzes:

You got it.

Dave Moore:

It's about 37%, 39%, there will be an impact. There will be an impact. It's not a surprise that there's going to be an impact and it's not shock that there's going to be an impact. But it felt like very much a standard response to owning a lot of government debt that's not in the hands of the dealers and accessible product class, but felt made in Canada. It felt so shocking that it came just before the meeting, that it was the week before it moves from 19 to 15 basis points. And you're like, "Oh my God. Okay, is this us getting set up for a micro cut? Does someone know something that someone else doesn't know?" and all of that kind of stuff. And they're reminded that this is transaction based and it's just supply and demand, and it's cash versus collateral and what's available. I do think though that what the Bank of Canada has done here, five years from now or so, they're going to come out looking like they were so ahead of the game, but I don't think it's because necessarily due to the decisions that are being made today.

I think that there's been prudent policy measures that have been put in place that have caused material distortions in our market. But I think that things are going to go quite well. And whether it's vaccines getting into people's hands and the economy slowly reopening, that's all fair and well. For me, it's an immigration story. For me, you have every single person who's looking at social issues in their home countries and saying, "Where do I want to be?" And as you know, recently, I don't even know what the right word is, I became Canadian, I am a Canadian citizen, when I received my citizenship, it was one of the proudest things that's ever happened to me, proudest moments of my life. And when I look at that, I'm not coming from some destitute place where there's war or where there's chaos or where there's lack of opportunity, or there's lack of availability of resources or any of that stuff. I'm coming from a developed, amazing country.

And I was so excited to move to Canada and spend most of my adult life there. And so I look at Toronto, for example, 150,000 people come to Toronto annually, COVID excluded, 90,000 odd of those people are international. They're coming with money, they're coming with the ability to try and be prosperous, and so if you have a queue out the door and around a couple of blocks to come to Canada for all the right reasons, the same reason I did, the same reason I'm so happy that I made that decision, that is going to have such a massive impact on the economy. It's just going to open the flood gates. And so two,

three years from now, Canada coming, saying, "Okay, we're shifting our stance on QE. We're shifting our stance on an emergency levels and policy," is going to look prophetic in the sense that everything from here on out probably does really well.

And I think it was just a really smart play. I know it might not be the right play and I knew that it hurt a lot people and I know that there's going to be consequences to this, but regardless of their decisions today, I see the bank-

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Dave Moore:

Regardless of their decisions today, I see the bank, and I see Canada particularly becoming, just like there's so much tailwind behind the story in Canada now, again, that just makes me really excited and it's got nothing to do with the Bank of Canada's decisions last week. It's nothing.

Ben Reitzes:

You've brought us to our question, one of the, one of the questions I asked at the beginning, which is, "Will the bank be a first mover among central banks?" But before we get to that in particular, I guess you read my piece from earlier this week. Immigration is, I agree, a huge theme, and if you consider the fact that we do bring in hundreds of thousands of people per year four to 500,000 over the past few years, you'd have to think there's pent up demand there.

Dave Moore:

Yeah, for sure.

Ben Reitzes:

The lineup is still there. People that wanted to come in 2020 still want to come, and there'll be more people going forward, and so I guess it's a question of how many people the government lets in. It might be 2022, but whenever the doors open, how open will they be? And that'll determine how much more we grow on top of what's already expected to be a really, really, really strong macro backdrop with households that have been cooped up at home for, I mean, God knows how long, just itching to spend their savings, itching to go on vacation, itching to get a haircut. God, I know I need one right now.

Dave Moore:

But think about this though; you have all the things you said, right? And I agree, but you've also have now a proven model that people don't have to be in the central district or centers of any major city to be able to function or do their jobs. So what used to be a very limiting factor for, particularly say Vancouver, or Toronto, and to a lesser degree, Montreal where all of the jobs are really central focused like Toronto, you've got legal, banking services and you have to be within a one hour or two hour range to get in there. Where a Canadian would happily say, "Oh yeah, I commute an hour, an hour and a half," to someone here in Hong Kong, 15 minutes is too long, an hour and a half is just never going to happen, right? It's just a different mindset.

And now we've opened up this entire new workspace that says you can live four hours outside of Toronto, or four hours outside of Vancouver, or four hours outside of Montreal. You can live anywhere. You might have to come in once a week, or you might have to come in twice a week, but you've now opened up an entire new living space for people coming to Canada that would have seen living in

Toronto or one of the major cities in Canada as just too expensive. And I think we're discounting that. I think we're not placing enough emphasis on this. And I think that's actually one of the biggest reasons why Canada will have huge tailwinds going into '22, '23, because it's no longer the need to live in Toronto, the need to live in Montreal, or Vancouver and pay however much it costs per month in rent or mortgage to live there. That, plus all of the people coming in is really down to, "Okay, Canada, how many people are we going to let in?" Because whatever that is, the upside is gigantic. It's just gigantic.

Ben Reitzes:

Yes. Things have definitely changed from a work perspective. I don't know if you want to live four hours North of Toronto, or Montreal, or Vancouver, and you can't go four hours South without changing countries. But I mean, we've already seen to some extent, a pretty big increase in demand for suburban living, call it, just moving kind of the outskirts of any of the cities. There's already been a shift that way. There's no reason to believe that that's not going to continue. What it's actually done, interestingly enough, as you've seen kind of the condo market cheapen up a little bit. So there's room for people everywhere here. Great White North, we got lots of space. So we will let people in and we'll see how many, and kind of go from there. So with that backdrop, immigration strong 2022, pent up demand, although everybody's got that part, will the Bank of Canada be among the first central banks to move? I know that there's an article in the National Post, suggesting as much. I personally lean that way to some extent, what are your thoughts on the bank being the first among, call it major global central banks, if we are a major global central bank, to move on policy, once we're through this pandemic?

Dave Moore:

I'm going to say we most certainly are a major global central bank. Yeah, I think that Canada will be the first mover of the G7, or G10, or whichever selection of countries you want to pick. Look at our OIS curve right? You've got March meeting pricing 20% or five basis points, right? 20% of a 25 basis point costs. By April of next year, that's essentially zero. So the curve isn't what we call meaningfully steep, right? It's five basis points to zero basis points. It's not like you're sitting there saying, "This is a super attractive trading opportunity." But when I look at that pricing of that curve and I say, "Well, is that under or overpriced?" I think what we end up seeing is we go down the SRO chain, and then relinquish a lot of the stress and the front end, flatteners probably have some more juice in them, but not a great deal.

We start to see bonds come back in, the Bank of Canada, rather than adding to QE will probably extend their WAM out to five since, probably if you want to talk about in WAM years, maybe two and a half years, they'll extend it further out, which will place a good amount of support for what's already a decent part of the curve on a carry and roll down perspective. So five sevens through tens will do well. They'll then sit there quite comfortably, and just let it trickle down, and then they will start to taper. But they'll do it similar, at least I think they'll do it similar in that kind of operation twist in which you extend the WAM out, start pushing bonds back into the system to get financial stability back under control, and get the front end under control, get repo rates under control, get that pinned in and done properly, while extending out.

I don't see as new net money coming into the system from the bank in the belly, or say the 10 year sector, I just see a gradual push out that curve, a gradual move, money coming back in and bonds being released into the front end. And then once we are satisfied with the money side of things, and that's where it really is what the bank, I think, are looking at this point is the capital balance between money available, money chasing assets, and that wall of cash that you spoke about earlier. Once the bank is satisfied that that's under some form of control, they'll then start to hint towards a tapering program,

and that's how I think this plays out. And I think this plays out quicker than, a year from now or two years from now. I think it's a more imminent thing than that. And so, yeah, I wouldn't be shocked at all if Canada's the first to come out and say that they were fairly comfortable with this idea that this is emergency only, and we need to start looking at the future,, and pushing forward with our proper normal day-to-day lives and proper normal day-to-day banking. And so, yeah, I think they will, for sure.

Ben Reitzes:

Sure. I'm with you there. Well, first I think tapering. The first taper move probably comes in April, just partially because of the better outlook, and we should be at least looking at spring and summer when we know that things are far more under control from a health perspective, but at the same time, we'll have the budget for a fiscal year 21/22, and issuance is going to be down significantly, and with that, the bank needs to be buying fewer bonds, as much as they'd love to provide more stimulus, they don't want to create more distortions in the market than they already have. So between the better macro backdrop, likely, assuming Q1's not absolutely horrific, and a decline in issuance, that will be significant, for the record a hundred billion plus or so, something along those lines, that they will be cutting, tapering their QE. So I think that means they cut their purchases to about 3 billion per week, from the current 4 billion. Macklin went out of his way to say that they're tapering is going to be very, very slow, that they're going to do it deliberately, it's going to be over a long period of time, kind of one step at a time thing. So from my perspective, that probably means like a billion at a time, so maybe a billion a quarter, or a billion every six months. It kind of depends on what the Fed's doing, but I see the first move is in April. And then, we kind of go from there. And whether the bank could be the first Central Bank to raise rates at the end of the day, again, that's probably not until late '22 at the earliest, at this point, and I'm generally the optimistic one, but still, late '22 at the earliest.

I think they can be. I think that the Bank of Canada has less of a global responsibility than the Fed, and so, when people like to say, "Well, the bank can't go without the Fed." Well, I'm not so sure about that; it depends what commodity price we're doing, where the currency is, there's a lot of issues there, but assuming the currency is well-behaved, the bank can hike first. And the rationale behind that for me is that global markets don't live and breathe what the bank of Canada says and does where their policy rates are. There's no global responsibility. If the Bank of Canada that makes a policy mistake and raises too early, hikes too early, and tightens too early, what impact is there on global markets? Well none, I mean, there's an impact on Canadian markets, but that's a domestic issue.

If the Fed makes a mistake on the other hand, the global financial system melts down. So, they have a far larger responsibility than the Fed, and so that gives them a green light to not be... I mean, if they're 95% sure they need to go, I think that's okay, whereas for the Fed, it has to be 100%, and then on top of that, you have the average inflation targeting versus what the Bank of Canada's doing, which is what we call, "Flexible inflation targeting." And so, I mean, I think that dynamic enables the bank at least to move first for now.

And on that topic, I mean, that brings us to inflation. What the outlook is for inflation in Canada, North America, globally. I think there there's lots of room for conversation there. Dave, you're bullish on the global macro backdrop kind of looking forward. So I'm assuming you're bullish on inflation as well?

Dave Moore:

Yeah. Oh yeah. But for the wrong reasons, I think. I'm bullish because, well, let's take the US first, then we'll go to Canada. But, you mentioned average inflation in the US, and I did a bit work on it because I thought, "Okay, at what point do policymakers start to get nervous?" Because, in our world, that's what we're really searching for is, was the stress, what is the surprise, the thing that causes chaos, panic,

carnage? That's what we're aiming for, right? Those tail risks, and trying to get bear grasp of them. So let's take the average inflation-

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Dave Moore:

... and trying to get a better grasp of them. Let's take the average inflation profile for the U.S. I don't know which arbitrary number they're going to pick, if it's two-year, three-year, five-year, but let's say it's five-year just because that's nice kind of half in between the start of the crisis and now. Let's just say five-year, just because it just makes sense to me.

The five-year average inflation right now in the U.S. is 1.95, using CPI and using their measures, one spot nine five, or one spot nine four eight, but let's round up, 1.95. And let's say the Fed are comfortable at 2.25 average. So 25, 30 bps from here. And I don't think that's a stretch 25 to 30 basis points from here in inflation numbers, I don't think is a stretch when you consider five-year/five-year inflation has moved 30 basis points higher since we the last spoke. I don't think it's a crazy, massive number that we're talking about, but in order to get us to that 2.25, using a five-year average, we need to get to 3.6% inflation by end of year, the end of this year, 2021.

If we had a move from a 1.95 average to 2.25 average, but to get there it took 3.6%, there's no central banker on earth that's going to sit and just be comfortable with that. And this is my issue is that inflationary pressures are there. And we say we're comfortable with moving to a less robust, arithmetic, like pure hard targeting inflation and more in average inflation. But even if you go to a two year target... Two year right now in the U.S. is, well, I don't know, you probably need 3.1, 3.2% to get us there, to get us to that 2.25.

So I struggle with this just arbitrary side of inflation management. I understand why we want to target inflation and I understand the whole purpose of inflation or inflation targeting. But when you look at the U.S., I think they have a much harder job to look through massive inflation prints to get us to that average. And I just don't see the same issues in Canada. As you say, they're much more flexible inflation target process.

But even if you talk about, okay, 30 beeps or 40 beeps or 50 beeps higher, as we're going, the numbers we're starting from, the base level in Canada is just so low. Like it's what? 1.65, if you're doing the five-year average, it's 1.65. We're really, really low. We haven't seen proper inflation build up in Canada in forever, like 10 year breaks are what? I don't know, 1.50. There's a lot of things there that are suggesting to me that Canada, relative to the peer group, relative to the broader inflation landscape is actually under priced.

The U.S. I think is much trickier because you get inflation spikes. I don't think they're going to sit and stand by and watch that happen and say, "Oh, it's inflation averaging." Because the minute... And we spoke about this last time. Inflation is self-fulfilling. The minute you start to think as a producer that the prices that you're going to sell your good for and the inputs required to make that good, the inputs are higher tomorrow than they are today, your price goes up. It just does. You're not waiting to see in CPI or PCE or RPI in the UK. You're not sitting waiting to see on a monthly basis. You're watching it happen as your input prices are going up, your cost to sell has to go up.

Now I would be remiss in not mentioning the fact that I don't believe we're as much of a manufacturing economy as we had been in the 1970s. And so in 1968, when you have oil go crazy and then the subsequent inflation that comes in '70s, at least '77, '78. I don't think that you're going to have that same type of inflationary problem because we're just not a manufacturing economy in the same way. A lot of what we do is either cloud based or a lot of what we do is tech based. A lot of what we do is not

production. And even if it is production, it's so quick to produce now. Clothing companies can turn around an entire line in six weeks, an entire line, and have it from concept to store in six weeks. They're not concerned about where the price of cotton is two years forward. It's a different landscape.

And so we have to, I think, step back and remind ourselves that when we look at history of inflation, the history of inflation is based on an economy that's manufacturing dominant, and we're just not there anymore. And that's okay. That's fine. But it doesn't mean that inflation can't exist. And so when, as I say, when I look at Canada and I look at the U.S. or other countries, I actually think Canada is starting from a much lower base with much higher potential inflation, partly because of the tailwinds we spoke about whether it's immigration and vaccines and recovery, and naturally steeper curves and all of those things. That's part of it.

But I also think when I look at inflation and I'm still kind of getting my head around, is this the appropriate way to look at inflation is, we're no longer in a world in which everyone cares about the lowest cost production. There's ethical decisions around who do you source from? From your production side. There's ethical decisions around how do you pay your labor? And where is that labor? I'm not comfortable buying a t-shirt made by a child the same age as my daughter, because it's the cheapest option. I'm just not comfortable with that. That's my preference. And so I will go out looking for a more ethically constructed garment. That's me, that's my personal choice.

Dave Moore:

And I do think that there is a natural draw towards more ethical product, procedure, and production line work. I also think you have questions around intellectual property, trade secrecy, and, as we've kind of evolved over the last few months, since we last spoke, just even looking at U.S. trade relations, and the Keystone is another one that we can talk about, but you look at what's happening, is people are going more introverted. People are coming home more in the production of goods.

And so I think, as we come home more in the production of goods, we're going to see broader price inflation due to people being more comfortable, spending a little bit more on a t-shirt that's made locally, or it's made in the United States, or it's made in North America. I think that there is going to be a natural draw in to control the supply chain, because what this crisis has taught us is that we were absolutely terrible at, not just Canada or the U.S., but generally in the developed world, we were terrible at supply chain management, terrible. That's what it should... Getting masks, N-95, getting hand sanitizer, whatever it was, it was almost embarrassing. It was almost comically embarrassing that we didn't have enough to help our own people. That's what this showed us.

And so I think that companies are going to look less towards the cheapest source, more towards ethical practice, more towards supply chain management and owning front to back, which comes at a higher price. If you want to buy a telephone or a mobile phone made in a developing nation versus made in the United States, that phone is going to cost you 4 to 10 times more. That's reality. That's the cost if you want to pay proper living wage, proper sourcing of input, that's reality. And as we become more inward looking, and as we become more ethical in our purchasing decisions, I actually think that that's really, really inflationary. It's one of those things that, I don't see enough talked about. And it's one of the sneaky little ones that, the Instagram world or the social media world that pushes out ethical kind of content. And I'm seeing it more and more frequently. I wouldn't be shocked that that is one of those tailwinds that we're really not planning for.

Dave Moore:

So put it with everything else that's happening, I think Canada's just one of those places that we could see material move in inflation. And I think the bank sees it too. And that's why they're so much more

comfortable talking about stepping back or at least slowing or removing the emergency level stimulus than other central banks have been, because the tailwinds we talk about, add in all of that, the inflationary price pressure buildup is material. It's very material in my mind.

Ben Reitzes:

So that's an interesting angle on inflation. I hadn't thought about it, I guess, from that perspective as much. I think about it more, just at least in the very near term, and I think your view would be kind of longer term. But very near term, I think, again, as you mentioned, we're less manufacturing driven, more services driven, which means inflation is more services driven and given the supply destruction on that side, on a lot of the services side over the past year and ongoing, when demand comes back, it may overwhelm supply. And that has the potential to at least cause a temporary spike in inflation. I wouldn't be shocked if in early '22 or late 2021, you got that kind of increase just because there aren't as many service providers of travel and other personal services as they were pre-pandemic. And then you also, on top of that, have this wave of demand that comes in. So I think there is that risk there. And then on top of that, you can layer that on your longer term views on production and that people bringing production back home.

Let's tackle one last question. Because I know you want to talk about this and so you want me to talk about this. So U.S.-Canada relations, Keystone XL was wiped off the map effectively last week and hopes to that are pretty much gone now. And they will not be revived anytime soon. That is, I guess, the initial imprint of the Biden administration on Canada. What are you most concerned about? What aspect of U.S. policy changes were you most? And maybe I can address those.

Dave Moore:

It's not so much... Like there's no one specific thing that really worries me, is that, as we just spoke about this inward looking process a lot of the economies and countries are going through now, and Trump was very focused on that. I don't think the new administration are going to move too far away from it. I do think that they'll continue that tone. And so I'm a bit concerned from a trading partner standpoint, Canada and the U.S. Keystone, just for a second, I think is a great example of just the natural tension that the two countries always have. And it's a good tension, but it's an impactful one, is that as we start to become more inward looking and you say, okay, well, production of lumber in Canada versus the U.S. and how we marry or how we merge, and we co-exist in this inward looking economy. It is starting to worry me. That, I think, is the concern. It's less so about this specific administration, but the stance they took on Keystone so early, like just so early showed, or at least expresses to me, the willingness to remain inward, looking at America first, without seeing in an aggressive manner, just showed it through a decision and how Canada responds to that. And what can Canada do to either cross the aisle or an olive branch if necessary, or what can we do at the government level, at the economic level to ensure the safety and the resources are necessary for us to continue to prosper?

Ben Reitzes:

The last part is a good question. I'm not sure I can answer that part. Well, what we can actually do, it's tough, but the US is going to continue to need a lot of the natural resources we provide. I think the Keystone move is, is just something based on history. I mean, when Biden was VP, they did not permit Keystone to move forward. And to some extent he's stuck with that decision from back then. He was part of that administration. You can't go back on that now. And the environmental side of things, the environmentalists, I mean, they put a lot of pressure on this administration to follow through with that. And so they don't want to be seen given the talk from the Democratic Party about being green, they

don't want to be seen going the other way early. And from their perspective, Keystone benefits Canada a lot more than the US at the end of the day. And so as many as jobs as it creates, that kind of longer-term picture is still Canada driven. And so, I mean, there's no big loss from their perspective. I think that they're okay with that.

Beyond Keystone it's tough. I think a lot of what Biden's done early in talking about forcing federal contracts to source their goods and such domestically so-called Buy America. I think a lot of that is driven by what we saw with Trump and the fact that that was a message that resonated with the general population. And it's just something that I think is important for them to at least say, just from a popularity perspective, but I'm not convinced they're going to follow through with that in any meaningful way. I think that's going to be something we see. Biden, I see him as being a more multi-lateral and a little bit more of, call it a little bit friendlier. At a minimum, at least on the surface, he won't be as confrontational as the Trump administration was. And so, honestly, I'm not sure that got Trump anywhere at the end of the day.

I mean, if you look at there... One of the promises walking into office four plus years ago was that the US's trade balance would go from deficit to surplus. And he ended with the biggest deficit on record. So there are some things that are more difficult than you think to get done. That would be one. So I think it's going to be a little more multilateral from Biden, less confrontation, and that should be beneficial for Canada, but I mean, we're, to some extent at their mercy, but on the back of the cancellation of the Keystone, I'm like, what are we really going to do? Are we going to put sanctions on the US? Are we go going to start a trade war? That's not something Canada can afford to do. And so it is a difficult relationship and we just need to make sure that when we can do them a favor, we do that. Just to make sure we stay in their good graces generally. That's my view. I'm not sure that's the broader view here in Canada, but I think that's the only really real way to play this thing. And just to make sure we stay as friendly as possible in any way we can.

Ben Reitzes:

From a rates and market perspective, I'm not convinced there'll be much impact overall on this. I mean, Keystone is a small negative for the oil sector. They weren't really likely going to need it until kind of the mid 2020s or something, even later than that, given the lower production profile for oil after the collapse in prices on the back of the pandemic. And really before that. So it's unfortunate. It's not the end of the world, I don't think at this point, but the irony of it is, is when oil production ramps up enough to need that space, it'll go by rail, which will cause even more pollution. So I guess, that's what they've asked for. That's the way life goes at the end of the day. Careful what you wish for.

Before we wrap up today, Dave, as I ask everybody, favorite trade idea. You can give me one, you can give me two, whatever you want. Let's hear it.

Dave Moore:

Yeah. So short term, I think we probably are on watch for that 1% break in 10-year. And there could be a material break lower if we go through it just on short covering and general feelings around the 1.9 trillion package and how long they'll take and why that's even in like in people's minds. It's kind of never guaranteed. But I do think that will probably cause a bit of wiggle and move. So I'll be watching 1% pretty closely. Less concerned about the FOMC. More concerned about positioning there, especially when you look at the TIC data and it looks like asset managers have turned short for the first time since like 2016, I guess. So I'll be watching that.

Longer-term, I'm still, you can't own long bonds. I'm going to stick with that for a very long time. And when we spoke last, I said that was a two to five years trade, I think. And I stand by that that's a two to

five-year trade. And at some point, the biggest risk that comes with long bonds with the bond market in general is people stop believing the central banks. People stop believing the credibility of the central banks to do anything and the value of the bonds that they are pushing out. And if that happens, you can have a 20% collapse in equities and bonds don't rally. You can have that happen. Especially in long bonds, you can have that happen. And so I'm just the very, very anxious or aware, or at least cautious of the back end of the curve.

And in every economy, I just dislike long bonds tremendously. And anything that is negative yielding is not an asset. And you're just hoping that you can sell it to someone else at some other point. And if that's someone else doesn't happen to be the central bank anymore, and everyone decides we don't like them as well, I think that's a lot of money going through a very small door and the moves will be exceptionally vicious. So that would be, yeah, by longer term, I still dislike the backend.

Ben Reitzes:

Cheaper and steeper. I'm with you there, especially in the near term agree, that there's room for a little bit of strength here, and we'll see how far that goes, but everyone should be selling that strength.

Dave Moore:

Well, like, think about it, like in my region here, the reason why I'm kind of there is that if you look at the MOF TIC data for Japan, like they were buying when 10 year yields were around 1.16, which gave them an equivalent yield using, 3m rolling forward FX, hedging costs of around 74, 75 basis points. That's only like, 10 beeps from here is probably supported in the 10-year and anything through 1% is a kind of stop out central sort of thing as people reevaluate and we consolidate around that. So that's kind of how I'd be trading it right now.

Ben Reitzes:

All right, cool. Thanks for joining me this week, Dave. I hope you enjoyed yourself and we'll speak to you again soon.

Dave Moore:

As always, thanks for having me.

Ben Reitzes:

Thanks for listening to Views from the North, a Canadian rates and macro podcast. I hope you'll join me again for another episode.

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