Intelligence MEMOS

From: Steve Ambler, Jeremy M. Kronick, and William B.P. Robson

To: Bank of Canada Watchers

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Re: **A Welcome Retreat by the Bank of Canada**

On March 23, the Bank of Canada announced the upcoming suspension of some of its major asset-purchase programs. This is good news.

Financial stresses at the beginning of the pandemic a year ago led the Bank to buy the debt of provincial governments and private companies. Those stresses are now in the past and Canadians should welcome its retreat from a role fraught with economic and political risks.

The suspended programs include the Commercial Paper Purchase Program, the Provincial Bond Purchase Program, and the Corporate Bond Purchase Program. The Bank established them when liquidity in the markets for these securities dried up a year ago, and they **succeeded**: their announcement and activation restored the functioning of these markets almost immediately.

The amounts held by the Bank under these programs were not huge. Provincial bonds represent by far the largest chunk, amounting to approximately $20 billion. This is tiny compared to the Bank's holdings of federal government bonds (close to $350 billion) and treasury bills (close to $45 billion) – and the Bank is currently committed to purchasing federal government debt at a rate of at least $4 billion per week.

The significance of these programs is not in their size, but their nature. It is one thing for the Bank to hold federal government debt – most central banks are, effectively, bankers to their national governments. It is quite another for it to hold debts of other governments and the private sector. That exposes the Bank to credit and political risk. Notwithstanding the programs' success at calming markets without huge Bank purchases, there are good reasons why central banks should not become a major player in these markets.

For one, the notion that the Bank will be there to buy up provincial and private-sector assets when markets for them become illiquid has the effect of lowering rates on these assets relative to others, potentially hiding the market's judgment of their relative riskiness.

Moreover, interfering with credit allocation belongs more to the domain of fiscal policy. Too active a role on the part of the Bank raises questions concerning the accountability of non-elected officials for such decisions, potentially undermining the Bank's operational independence.

Beyond these operational concerns, a move away from such credit allocation policies provides more freedom for the Bank to use its balance sheet to focus on attaining its primary monetary policy goal: getting inflation back to the 2-percent target.

To this end, the Bank also announced the wind-down of two other programs. It will suspend its Term Repo operations on May 10, and deactivate its Contingent Term Repo Facility today. With the Bank's balance sheet including more than $130 billion of securities purchased under resale agreements (repos), such a move is a signal to the market to prepare for a further shrinking of the balance sheet as these assets mature.

How quickly the assets under all these suspended programs do mature depends on their maturity structure. We don't know the details, but the Bank also announced that it will publish (on June 29) transaction-level data from its discontinued purchasing programs. This should allow analysts to calculate the implications for the evolution of the Bank's balance sheet.

As the economy moves towards full capacity and inflation picks up, the Bank will be able to tighten monetary policy first by shrinking its balance sheet before then turning to increasing its target overnight rate. With all the private and public debt accumulated both pre-pandemic and over the course of the last year, this is also a good thing.

Positive news concerning the state of the economy and the pace of vaccinations will likely lead the Bank to announce a slower rate of federal government bond purchases with its next interest rate announcement later this month.

Much has changed in the last year. The ending of these asset purchase programs is a positive sign. Getting inflation back to target is a large enough challenge for the Bank of Canada. Being a banker for provincial governments and Canada's private sector as well is a job too far.

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