Don’t point the finger at Poloz for our languishing loonie

By Kevin Carmichael
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Currency traders may never let Bank of Canada Governor Stephen Poloz escape his past.

Poloz was a rising star at the central bank in the early 1990s when he quit to join a private research firm. In 1999, he joined Export Development Canada as chief economist, and in 2010 he was named president and chief executive officer. He would have interacted with hundreds of exporters during those years. So as far as some on Bay Street are concerned, he’s essentially one of them; installed in Ottawa to do their bidding, a Manchurian Candidate in control of monetary policy.

And what does Big Export want? A weaker dollar, of course.

“Poloz, who’s very much a trade advocate, will orchestrate a lower Canadian dollar to help Canada’s exports sector,” Peter Kotsopoulos, chief executive officer and director of fixed income at Toronto-based MFS Investment Management Canada Ltd. told Bloomberg News this week.

Bloomberg caught Kotsopoulos at a good time. Poloz had given a speech the day before in which he expanded on why he thinks there is slack in the labour market, even though the unemployment rate is at its lowest level in at least four decades. The currency plunged about a cent after the remarks, dropping to US77¢, as traders took the comments to mean the Bank of Canada was in no hurry to raise interest rates.

That was already Kotsopoulos’s assumption. The Canadian currency was having a lacklustre 2018, but up until this week, the majority of forecasters saw it gaining strength over the remainder of the year. “I don’t agree with the consensus forecast,” Kotsopoulos said. His contrarian opinion looks smart. The currency kept falling and was trading at about US76¢ when Bay Street started shutting down for the weekend.

When I got my start in this business two decades ago, at Bloomberg, I was conditioned to revere men and women who manage money. They have something at stake, so they will have taken the time to understand the world better than anyone else. That’s why Kotsopoulos was featured on the Bloomberg terminal. He manages a $500-million bond fund that returned 15 per cent over three years, better than his peers. Therefore, he must know something that the rest of us don’t.

And he might. But the idea that Poloz is trying to “orchestrate” a weaker currency shows that even the most successful Masters of the Universe are suckers for urban legends. The Bank of Canada isn’t “looking” for reasons to leave borrowing costs low, as Avery Shenfeld, chief economist at CIBC World Markets, said this week. Rather, it’s simply waiting for the coast to clear.

The Canadian dollar’s initial tumble this week was strange. Poloz said nothing in his speech at Queen’s University on March 13 that the central bank hadn’t communicated in its latest policy announcement on March 7 and in its “economic progress report,” delivered by Deputy Governor Timothy Lane in Vancouver on March 8.

The drop suggests traders still put extra emphasis on the boss’s words, despite everything Poloz has done in recent years to emphasize that policy is a group decision.

Ranko Berich, head analyst at Monex Canada, a seller of foreign-exchange contracts, said in an interview that the explicitness of Poloz’s comments about the possibility of creating jobs for hundreds of thousands of marginalized workers left an impression on traders.

Of course, many of them read those remarks under the assumption that Poloz will use any excuse to put downward pressure on the exchange rate. Kotsopoulos's view, "is a fair characterization of a lot of people's opinions," Berich said. "Poloz is canny about how he says things. He's aware of the market implications of those kinds of comments."

It's true that Poloz talks more freely about the currency than did his predecessors. But he's not trying to manipulate its value, at least as far as I can tell after observing him fairly closely for nearly five years. Poloz is simply more honest about the fundamental role the exchange rate plays in monetary policy.

The Bank of Canada's job is to control inflation, which is determined by aggregate demand and expectations of future prices. Policymakers influence the latter by hitting their inflation target. Aggregate demand is shaped by two things: longer-term interest rates and the exchange rate. So yeah, Poloz cares about the dollar, just as his immediate predecessors did. The difference is that they tended to pretend they didn't.

All this matters. Those who see Poloz as a currency manipulator may be missing signs that the Bank of Canada is closer to raising interest rates again than many seem to think. (Berich said the probability of an interest-rate increase by May dropped to about 50 per cent this week from 70 per cent a month ago.)

Yes, the rate of economic growth was slower in the fourth quarter than the Bank of Canada predicted, but Poloz said this week that revisions show the actual level of output was in line with expectations. The central bank also noted in its policy statement that credit growth is slowing, a positive because it suggests households are taking control of their borrowing. That would remove a barrier to raising interest rates, as one of the reasons policymakers gave for keeping them low was to help highly leveraged borrowers manage their debts.

Poloz and his deputies are taking an opportunistic approach to raising interest rates. They lifted their benchmark in January, but emphasized they were concerned that uncertainty around the future of the North American Free Trade Agreement was hurting foreign direct investment. They opted against an interest-rate increase earlier this month because uncertainty about trade had worsened.

What might happen if those headwinds ease? Rates will rise. If the dollar's value was based on that outlook at the start of the week, then the drop was overdone. Nothing changed.