BoC: Bank underestimated impact of supply-side shocks on inflation, Macklem says

FROM B1

This delay makes it hard to judge the impact of rate hikes in real time and creates the risk of over-tightening monetary policy.

The bank's next rate announcement is on Jan. 25. Mr. Macklem said the decision about whether to press pause would depend on incoming data.

In a speech last week, Bank of Canada deputy governor Sharon Kozicki said the bank was still willing to be "forceful" with rate increases, if economic data came in stronger than expected. Mr. Macklem's focus on Monday on the upside risk to inflation suggests a January pause is not necessarily the base-case scenario.

Recent economic data have been mixed. Inflation is trending down, but also broadening out, impacting a wider range of goods and services. The Canadian economy grew much faster than the bank expected in the third quarter, but there are also signs that rate hikes are starting to bite. Household spending fell 0.3 per cent in the third quarter, the first drop since the second quarter of 2021.

Much of Mr. Macklem's speech was devoted to what the central bank has learned over the past year as inflation surged to the highest level in four decades. In particular, Mr. Macklem said the bank underestimated the impact of supply-side shocks on inflation. These included factory shutdowns and shipping backlogs during the first two years of the pandemic, as well as Russia's invasion of Ukraine this year, which pushed oil and other commodity prices sharply higher.

"Since we started inflation targeting in the early 1990s, we have not been hit by large negative supply shocks at the same time as our economy was overheating," he said.

"The lesson from 2022 is that even if long-term inflation expectations are well anchored, when the economy is in excess demand, businesses raise their prices more quickly and by more when their costs increase."

The speech also pointed to potential challenges for the central bank ahead. Many of the tectonic forces that have put downward pressure on prices in recent decades, including the expansion of global trade and the entry of Chinese and Eastern European workers into world labour markets, seem to be going in reverse. The COVID-19 pandemic and Russia's invasion of Ukraine have shaken assumptions about the global economy.

Bank of Canada Governor Tiff Macklem gives his year-end speech at an event held by the Business Council of British Columbia in Vancouver on Monday. JENNIFER GAUTHIER/REUTERS

"In the future, it seems likely that supply chains will be shorter, more diversified and more resilient. Trade will likely narrow to more trusted partners. These changes will increase resilience but at the cost of efficiency. And through this adjustment, production costs could rise, increasing price pressures," Mr. Macklem said.

He said these changes could make it harder to control inflation. "How much harder is very difficult to say."

Carbon capture: Critics of technology worry about future CO2 leaks

FROM B1

Oil sands producers are betting big on carbon capture for the industry's survival. The technology captures greenhouse gas emissions and pushes them deep underground to keep them out of the atmosphere. It's already in use around the world, including in Alberta via Shell Canada's Quest project at the Scotford Upgrader outside Edmonton and in southern Saskatchewan at the Boundary Dam power plant.

But carbon capture has its doubters. Critics worry about future CO_2 leaks and the fact it doesn't encourage the reduced reliance on fossil fuels that is critical to meeting climate goals.

The technology also remains extremely expensive, which is a tough sell for fossil fuel companies that have to justify to their shareholders immense capital and operating costs on something that doesn't generate revenue.

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To help defray those costs, the federal government recently released details of a carbon capture investment tax credit covering 50 per cent of capital expenses.

The alliance was hoping for a boost to the tax credit so it more closely reflects a higher one recently introduced in the United States. Still, Mr. Dilling said Canada's program presents an excellent opportunity to future-proof the oil sands "so that we can continue to provide literally trillions of dollars in GDP over the coming decades, as long as the world needs oil, providing a decarbonized barrel of oil to that market."

Canada has worked hard "to be a leader on environmental issues," he added.

"I think [2023] is the year where we really decide, 'Yep, this is what the future looks like for this country and we're going to get after it.' "

BMO: Analysts estimate bank could risk falling below new minimum capital level

FROM B1

As part of the private placement, BMO will pay each of the institutional investors a fee equal to 3.5 per cent of the respective purchase price.

The share sale is about 3.9 per cent of the lender's 677.1 million outstanding shares. BMO previously raised $2.7-billion by selling stock in March to help pay for its pending $17.1-billion acquisition of California-based Bank of the West from BNP Paribas.

Other than the private placement to BNP Paribas, the deal is expected to close on Friday. The private placement with BNP is contingent on the closing of the Bank of the West deal, which is expected early next year.

Several banking analysts said last week that BMO would be the bank most affected by OSFI's increase to the minimum capital threshold. Some estimated that BMO could be at risk of falling below that new level when it closes its Bank of the West purchase.

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BMO recently bumped back its target date to close the deal by up to three months, to the first calendar quarter of 2023. The bank had originally hoped to seal the acquisition by the end of 2022.

Last Thursday, OSFI said it will raise its domestic stability buffer from 2.5 per cent of risk-weighted assets to 3 per cent – requiring banks to build up a larger store of capital that could later be released during tougher economic times to help absorb credit losses and keep banks lending. OSFI also expanded the domestic stability buffer's range: The previous maximum level was 2.5 per cent, but the regulator can now set it anywhere from 0 to 4 per cent.

That means OSFI now has the capacity to raise minimum capital levels even higher. But each increase adds to the capital burden on banks, restricting the amount of money they have to reinvest in their businesses or pay dividends to shareholders.

With Monday's share sale, the lender said that it is targeting a common equity tier 1 ratio – a measure of the bank's ability to sustain losses – of at least 11.5 per cent. That is half a percentage point higher than the new minimum threshold set by OSFI, which will be 11 per cent starting on Feb. 1, giving BMO an added margin of safety.

Adding to the pressure on BMO's capital levels, the bank took a $1.1-billion charge last month after a U.S. court found BMO's U.S. subsidiary liable for damages in a lawsuit related to one of the largest Ponzi schemes in history. BMO plans to appeal the decision.