Monetary Policy Council

Communiqué

January 20, 2022

C.D. Howe Institute Monetary Policy Council Calls for Bank of Canada to Raise Overnight Rate, Shrink Bond Holdings

January 20, 2022 – The C.D. Howe Institute's **Monetary Policy Council** (MPC) recommends that the Bank of Canada raise its target for the overnight rate, its benchmark policy interest rate, to 0.50 percent at its next announcement on January 26th. The Council recommended further increases over the coming year, with the target reaching 1.50 percent by January of 2023. It also recommends that the Bank reduce its holdings of Government of Canada bonds prior to its next overnight rate target announcement in March.

The MPC provides an independent assessment of the monetary stance consistent with the Bank of Canada's 2 percent inflation target. **William Robson**, the Institute's CEO, chairs the Council. Council members make recommendations for the Bank of Canada's upcoming interest-rate announcement, the subsequent announcement, and the announcements six months and one year ahead. The Council's formal recommendation for each announcement is the median vote of members attending the meeting. The Council also offers a view on the Bank's quantitative easing program: on this occasion, members voted on whether the Bank should shrink, maintain, or increase its holdings of Government of Canada bonds.

The call for the Bank to raise the overnight rate target next week was a close one: six of the 11 members of the MPC attending this meeting recommended an increase to 0.50 percent, while five recommended that the Bank hold the target at 0.25 percent. Although the median call for the target at the following announcement in March was also 0.50 percent, the balance of sentiment contrasted sharply: six of the members recommended 0.50 percent, while five recommended 0.75 percent. None recommended that the overnight rate target stay at its current level by March. In six months' time, five members called for a target of 1.00 percent, with three calling for a lower target and three for a higher one. A year ahead, five members called for a target of 1.50 percent and, again, three called for a lower target and three for a higher one (see table below).

Eight of the 11 members called for the Bank to reduce its holdings of bonds and three called for it to maintain its holdings at current levels. None called for it to increase its holdings of bonds.

Recent inflation numbers well above the Bank of Canada's 1-to-3 percent target range, and evidence that expectations of inflation are moving above the Bank's 2 percent target, were the key factors underlying the MPC's desire to see the overnight rise over the next year and the Bank's holdings of government bonds shrink. Demand propelled by still-high household savings outrunning supply, which has been

constrained by the direct effects of COVID-19 and measures to contain the virus, was a major focus of the conversation. Among the indicators of an economy with persistent inflationary pressure cited by Council members were: strong commodity prices, a frothy housing market, tight labour-market conditions, and measures of household and business sentiment showing desire to spend and expectations of higher prices.

Higher inflation expectations were decisive in many members' recommendations for a higher overnight rate. Although some members pointed out that some measures of longer-term expectations are still close to 2 percent, and that base effects will lower the year-over-year CPI measure in coming months, others emphasized that higher inflation expectations in the short and medium term meant that the overnight rate has become effectively lower, and strongly negative in real terms. Notwithstanding uncertainty about the level of the overnight rate that would be neutral – consistent with steady inflation at 2 percent – and about the possible need for the overnight rate to exceed that level to rein inflation in, all members judged that a higher rate was appropriate over time.

The principal reason for differences in recommendations about the timing of the first overnight-rate increase was the uncertain impact of the Omicron variant on demand, on supply, and therefore on inflation. The desirability of not getting out of step with the US Federal Reserve, and the fact that the Bank had signaled no overnight rate increases in the near term, also led some members to recommend that the Bank should not move next week. Several members also emphasized that the Bank's large balance sheet is responsible for easy monetary conditions, including an actual overnight rate that has been consistently below the target, and urged that the Bank stop new purchases of government bonds before raising the overnight rate target.

Votes of MPC Members and the Council Median for Each Announcement (*percent*)					
MPC Members	**Jan 26, 2022**	**Mar 2, 2022**	**July 13, 2022**	**Jan 23, 2023**	**QE VOTE**
Steve Ambler Université du Québec à Montréal (UQAM)	0.50	0.75	1.25	2.00	Shrink
Edward A. Carmichael Ted Carmichael Global Macro	0.50	0.75	1.50	2.50	Shrink
Michael Devereux University of British Columbia	0.50	0.75	1.00	1.50	Shrink
Stéphane Marion National Bank of Canada	0.50	0.75	1.00	1.50	Maintain
Angelo Melino University of Toronto	0.25	0.50	0.75	1.25	Shrink
Jean-François Perreault Senior VP and Chief Economist, Scotiabank	0.50	0.75	1.75	2.25	Shrink
Douglas Porter BMO Capital Markets	0.25	0.50	1.00	1.50	Maintain
Avery Shenfeld CIBC	0.25	0.50	0.75	1.25	Shrink
Pierre Siklos Wilfrid Laurier University	0.25	0.50	1.00	1.50	Shrink
Stephen D. Williamson Western University	0.50	0.50	1.00	1.50	Shrink
Craig Wright RBC	0.25	0.50	0.75	1.25	Maintain
Median Vote	0.50	0.50	1.00	1.50	N/A

The views and opinions expressed by the participants are their own and do not necessarily reflect the views of the organizations with which they are affiliated, or those of the C.D. Howe Institute.

The MPC's next vote will take place on February 24, 2022 prior to the Bank of Canada's interest rate announcement on March 2, 2022.

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