Monetary Policy Council

Communiqué

February 24, 2022

C.D. Howe Institute Monetary Policy Council Calls for Bank of Canada to Raise Overnight Rate to 0.50 Percent Next Week on Way to 1.75 Percent in a Year's Time, and Shrink Bond Holdings

February 24, 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 on March 2nd, with further increases to 0.75 percent in April, 1.25 percent by September, and 1.75 percent this time next year. It also recommends that the Bank reduce its holdings of Government of Canada bonds between now and its April overnight-rate target announcement.

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 at its upcoming announcement was unanimous: 10 of the 11 members attending the meeting voted for a target of 0.50 percent and one voted for a target of 0.75 percent. The call for another increase in April was also unanimous: nine members voted for a target of 0.75 percent and two voted for a target of 1.00 percent. Six months ahead, five members voted for a target of 1.25 percent, with three voting for targets below, and three for targets above, that level. A year out, the votes ranged from lows of 1.50 to highs of 2.50.

Ten of the 11 members urged the Bank to reduce its holdings of bonds, and one urged it to maintain them. None urged an increase.

The consensus in favour of hikes in the overnight rate at the upcoming and April announcements reflected the Council's view that the Bank needs to act to rein in inflation. Members cited the 5-percent-plus year-over-year increase in the CPI, increases in measures of "core" inflation well above the Bank's target, recent increases in prices of many commodities, notably energy, and pervasive constraints on the economy's productive capacity. The fact that an overheated housing market will continue to boost CPI measures over the next year featured in the conversation. Several members noted that the Bank of

Canada had ample reason to raise the overnight rate at its last announcement in January, and argued that failing to raise it this time would undermine the credibility of its inflation target. Similar reasoning supported the strong majority view that the Bank should reduce its bond holdings.

The Council discussed many developments that could affect the outlook for growth and inflation over the coming year, with Russia's invasion of Ukraine heading the list of concerns. Notwithstanding the invasion's negative implications for the region and European confidence, and repercussions in the financial system and cyber-security, the group judged that its negative supply-side effects – particularly with respect to energy and food – were most important for monetary policy. Although the discussion touched on the challenge of responding to changing relative prices – not over-reacting to increases in particular commodities – the group judged that the probability of higher war-related inflation in the near term reinforced the need for a higher overnight rate.

With respect to the Bank's holdings of government bonds, the group noted that letting existing holdings mature will not always, by itself, be enough to shrink the Bank's balance sheet between announcement dates. Several members argued that selling bonds and other active measures to shrink the balance sheet were appropriate, given the need to adjust to an inflation-fighting stance.

The group was divided with respect to forward guidance: while some members wanted the Bank to communicate its intentions with respect to the overnight rate and its balance sheet more clearly, others noted the challenges of communicating contingent intentions. The majority noted, however, that the Bank could usefully stress its determination to bring inflation back to target more forcefully.

Votes of MPC Members and the Council Median for Each Announcement (*percent*)					
MPC Members	**Feb 24, 2022**	**April 13, 2022**	**Sept 7, 2022**	**Feb 23, 2023**	**QE VOTE**
Steve Ambler Université du Québec à Montréal (UQAM)	0.50	0.75	1.50	2.50	Shrink
Beata Caranci TD Bank	0.50	0.75	1.25	1.75	Shrink
Edward A. Carmichael Ted Carmichael Global Macro	0.75	1.00	1.50	2.50	Shrink
Michael Devereux University of British Columbia	0.50	0.75	1.25	1.75	Shrink
Angelo Melino University of Toronto	0.50	0.75	1.00	1.50	Shrink
Jean-François Perreault Senior VP and Chief Economist, Scotiabank	0.50	1.00	1.75	2.25	Shrink
Douglas Porter BMO Capital Markets	0.50	0.75	1.25	1.75	Maintain
Avery Shenfeld CIBC	0.50	0.75	1.00	1.50	Shrink
Pierre Siklos Wilfrid Laurier University	0.50	0.75	1.25	1.75	Shrink
Stephen D. Williamson Western University	0.50	0.75	1.25	2.00	Shrink
Craig Wright RBC	0.50	0.75	1.00	1.50	Shrink
Median Vote	0.50	0.75	1.25	1.75	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 April 7, 2022 prior to the Bank of Canada's interest rate announcement on April 13, 2022.

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