

April 7, 2022

C.D. Howe Institute Monetary Policy Council Calls for Bank of Canada to Raise Overnight Rate to 1.00 Percent Next Week and 2.25 Percent in a Year's Time, and Shrink Bond Holdings

April 7, 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, by 50 basis points to 1.00 percent on April 13th. The MPC recommends further increases over the coming year: to at least 1.25 percent in June, 2.00 by October, and 2.25 percent by April 2023. It also recommends that the Bank reduce its holdings of Government of Canada bonds between now and its May 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. When the median vote is not an increment of 25 basis points, as occurred this time with the June and October settings, the mean of the recommendations determines the direction of rounding. If the mean is the same as the median, as occurred with the June setting, the recommendation is rounded in the direction of the previous setting.

The Council also offers a view on the Bank's balance sheet. 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 its overnight rate target by 50 basis points at its upcoming announcement was unanimous: all 10 of the members attending the meeting supported it. The call for another increase in June was also unanimous: five members favoured a target of 1.25 percent and five a target of 1.50 percent (rounding in the direction of the previous setting produced the formal recommendation of 1.25 percent). By October, five members favoured a target of 1.75 percent, three favoured 2.00 percent, and two favoured 2.25 percent. By April of 2023, the votes ranged from lows of 2.00 percent to highs of 3.00 percent.

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The call for the Bank of Canada to reduce its holdings of bonds was unanimous.

The strong support for the Bank to raise the overnight rate and shrink its balance sheet reflected the fact that inflation in Canada is well above the Bank's 2 percent target, and that monetary policy needs to be substantially tighter to bring it down. Key themes in the MPC's conversation at this meeting were indicators of robust activity in Canada in early 2022, notably the strong labour market, and evidence that price pressures are causing expectations of inflation to move above the target. Higher government spending and the prospect of a federal budget featuring new programs and borrowing were also a concern. Many members worried that rising inflation expectations and wage pressures are raising the future level of the overnight rate that will ultimately be needed to bring inflation down, and urged the Bank to move faster than it has so far signaled.

The group noted some developments abroad with negative implications for Canadian exports and growth – notably Russia's invasion of Ukraine, COVID-related lockdowns in China, and tightening by central banks, notably the US Federal Reserve. On balance, however, members judged that the invasion and lockdowns were at least as problematic for supply as for demand, and should not slow the Bank of Canada's move to higher interest rates.

The group debated the sensitivity of the Canadian economy to a higher overnight rate, and to the impacts of balance-sheet reductions on the part of both the Bank of Canada and the Federal Reserve. Uncertainty on these topics is high in part because interest rates have been so low for so long, and because central banks have not held such quantities of bonds before. While some members noted that the Bank of Canada will need to monitor developments in financial conditions carefully as a result, these considerations did not stop the group recommending substantial increases in the overnight rate, and a shrinking of the Bank's bond holdings, to bring inflation in Canada back to 2 percent.

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Votes of MPC Members and the Council Median for Each Announcement (*percent*)

| MPC Members | April 13, 2022 | June 1, 2022 | Sept 7, 2022 | Feb 23, 2023 | QE VOTE |
|---|-------------------|-----------------|-----------------|-----------------|---------|
| Steve Ambler Université du Québec à Montréal (UQAM) | 1.00 | 1.50 | 2.25 | 2.75 | Shrink |
| Edward A. Carmichael Ted Carmichael Global Macro | 1.00 | 1.50 | 2.25 | 3.00 | Shrink |
| Michael Devereux University of British Columbia | 1.00 | 1.50 | 1.75 | 2.25 | Shrink |
| Stefane Marion VP & Chief Economist, National Bank of Canada | 1.00 | 1.25 | 2.00 | 2.00 | Shrink |
| Angelo Melino University of Toronto | 1.00 | 1.25 | 1.75 | 2.00 | Shrink |
| Jean-François Perreault Senior VP and Chief Economist, Scotiabank | 1.00 | 1.25 | 2.00 | 3.00 | Shrink |
| Douglas Porter BMO Capital Markets | 1.00 | 1.50 | 2.00 | 2.50 | Shrink |
| Avery Shenfeld CIBC | 1.00 | 1.25 | 1.75 | 2.25 | Shrink |
| Pierre Siklos Wilfrid Laurier University | 1.00 | 1.50 | 1.75 | 2.25 | Shrink |
| Stephen D. Williamson Western University | 1.00 | 1.25 | 1.75 | 2.00 | Shrink |
| Median Vote | 1.00 | 1.25 | 2.00 | 2.25 | 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 May 26th, 2022, prior to the Bank of Canada's interest rate announcement on June 1st.

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