Monetary Policy Council

Communiqué

May 26, 2022

C.D. Howe Institute Monetary Policy Council Calls for Bank of Canada to Raise Overnight Rate to 1.50 Percent Next Week and 2.00 Percent in July, and Sell Bonds

May 26, 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 1.50 percent on June 1st. The MPC recommends further increases over the coming year: to 2.00 percent in July, and 2.50 by December. It also recommends that the Bank accelerate its planned reduction in its holdings of Government of Canada bonds.

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 balance sheet. On this occasion, members voted on whether the Bank should accelerate, maintain, or slow its planned reduction in bond holdings.

The call for the Bank to raise its overnight rate target by 50 basis points at its upcoming announcement was unanimous: all nine of the members attending the meeting supported it. The call for another increase in July was also unanimous: three members favoured a target of 1.75 percent and six a target of 2.00 percent. By December, three members favoured a target of 2.25 percent, four favoured 2.50 percent, and two favoured 3.00 percent. Although the median vote for the overnight rate target in 12 months' time was still 2.50 percent, the mean was markedly higher than its December counterpart: five members favoured 2.50 percent, and the votes of the remaining four ranged from 2.75 percent to 4.00 percent.

In its April 13th announcement, the Bank of Canada said it would stop replacing maturing Government of Canada bonds after the April 21st auction, and that its holdings of Government of Canada bonds, and its overall balance sheet, would shrink as its current holdings mature. MPC members addressed the question: Between June 1st and its next fixed announcement date on July 13th, should the Bank accelerate, maintain, or slow its planned reduction in bond holdings? Eight of the nine members called for the Bank of Canada to accelerate its planned reduction, and one member called for the Bank to maintain it.

The MPC's desire to see the overnight rate target at least 1 percent higher by December reflected the fact that the CPI's latest year-over-year increase of 6.8 percent is far above the Bank's 2-percent target, and that its increases have consistently outpaced forecasts, including those from the Bank of Canada, for months. The Council canvassed several indicators of near-term activity, noting some weakness in growth overseas, and negative sentiment from financial market weakness and inflation outpacing earnings. On the whole, however, the group judged that support from a growing US economy and the strength of domestic demand in Canada meant that spending would continue to match or exceed productive capacity for the foreseeable future, and that higher short-term interest rates were necessary to bring inflation back down.

The MPC discussed constraints on global and domestic productive capacity at some length, noting that some measures of supply-chain stresses had improved, but that production of some products, notably fossil fuels and food, seemed likely to be well short of demand for a long time. Many members felt that most of the price impact of supply constraints were now behind us and that inflation would therefore subside, but some felt that inflation had developed momentum, and that breaking that momentum will require more monetary restraint than central banks, including the Bank of Canada, have signaled.

The Council's discussion of the Bank of Canada's balance sheet highlighted the importance of its liabilities in shaping monetary conditions, independent of what happened to its assets. Some members did not expect that a decision by the Bank to accelerate, maintain or slow the reduction of its bond holdings relative to the pace dictated by maturities would affect interest rates or inflation much. Other concerns about the Bank's having become such a large holder of Government of Canada bonds help explain the strong majority vote in favour of accelerating the reduction.

Votes of MPC Members and the Council Median for Each Announcement (*percent*)					
MPC Members	**June 1, 2022**	**July 13, 2022**	**Dec 7, 2022**	**June, 2023**	**QT VOTE**
Steve Ambler Université du Québec à Montréal (UQAM)	1.50	2.00	3.00	3.50	Accelerate
Beata Caranci TD Bank Group	1.50	2.00	2.50	2.50	Maintain
Edward A. Carmichael Ted Carmichael Global Macro	1.50	2.00	3.00	4.00	Accelerate
Michael Devereux University of British Columbia	1.50	2.00	2.50	3.00	Accelerate
Angelo Melino University of Toronto	1.50	1.75	2.25	2.50	Accelerate
Avery Shenfeld CIBC	1.50	2.00	2.25	2.50	Accelerate
Pierre Siklos Wilfrid Laurier University	1.50	1.75	2.50	2.75	Accelerate
Stephen D. Williamson Western University	1.50	1.75	2.25	2.50	Accelerate
Craig Wright RBC	1.50	2.00	2.50	2.50	Accelerate
Median Vote	1.50	2.00	2.50	2.50	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 July 7, 2022, prior to the Bank of Canada's interest rate announcement on July 13.

* * * * *

Contact: Mawakina Bafale; e-mail: mbafale@cdhowe.org.