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## C.D. Howe Institute Monetary Policy Council Calls for Bank of Canada to Raise Overnight Rate to 2.25 Percent Next Week and 3.25 Percent by 2023

July 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 75 basis points to 2.25 percent on July 13th. The MPC recommends further increases over the coming year: to 2.75 percent in September and 3.25 percent by January 2023. Its call for the overnight rate in a year’s time was also 3.25 percent. The MPC also recommends that the Bank maintain the current pace of reduction in its holdings of Government of Canada bonds between now and September.

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 the planned reduction in its holdings of Government of Canada bonds.

Eight of the 11 members attending the meeting supported a 2.25 percent target for the overnight rate at the upcoming announcement. One favoured a target of 2.50 percent, while two favoured a target of 2.00 percent. The call for the September announcement was more dispersed, with five members supporting a target of 2.75 percent, while three favoured a higher target and three favoured a lower one. By January of 2023, the median call was up to 3.25 percent, with the distribution skewed downward. In a year’s time, the distribution was more balanced around the median of 3.25 percent (see table below).

The Bank of Canada’s current policy with respect to its holdings of Government of Canada bonds is to buy nothing and let its holdings shrink as the bonds mature. Eight MPC members called for the Bank of Canada to maintain that schedule, while three called for the Bank to accelerate it by selling bonds.

The consensus in favour of a higher overnight rate and reduction of the Bank’s bond holdings reflected the fact that recent inflation readings have consistently exceeded what the Bank and other forecasters expected, and that inflation so far above the Bank’s 2 percent target requires tighter monetary policy

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to reduce it. The discussion during the meeting touched on a number of factors that might reduce the pressure of demand on productive capacity and prices. Among them were slower growth abroad, notably in the United States, lower prices for many growth-sensitive commodities, and early signs of weakness in the housing market. Members gave substantially more weight, however, to factors pointing to continued upward pressure on demand and prices. Among them were the strong jobs market and a pickup in wage growth, willingness of households and businesses to spend, and fiscal policy that is too expansionary for this point in the cycle, at both the federal and provincial levels.

With respect to inflation, the group noted that inflation expectations are no longer anchored at 2 percent, with substantial divergence among forecasters. While growth of the monetary aggregates has slowed from its rapid pace in 2021, many members cited measures, such as the gap between the overnight rate and inflation, indicating that the Bank had fallen behind where it needed to be. Some members also noted that measures of “core” inflation did not give timely warning of the pickup in inflation.

Other major points of discussion among the group were the sensitivity of the housing market to interest rate increases, with some members emphasizing the high levels of mortgage debt at variable rates and others emphasizing that higher mortgage rates will take many months to affect household cash flows. A number of members emphasized the desirability of policies that would temper the need for the Bank of Canada to bring inflation down by restraining demand, such as greater fiscal restraint and structural policies that would support growth of productive capacity.

At the MPC’s last meeting in June, all but one member had voted for the Bank to accelerate its planned reduction of bond holdings. On this occasion, some members who voted for the Bank to maintain its planned reduction noted that an unusually large amount of bonds will mature between now and September 7th, which inclined them to vote against bond sales this time. In general, MPC members judged that continued shrinking of the Bank’s balance sheet is appropriate as part of its effort to get inflation back to target.

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

MPC Members	July 13, 2022	Sept 7, 2022	Jan 2023	July 2023	Reduction in Bond Holdings
<b>Steve Ambler</b> Université du Québec à Montréal (UQAM)	2.50	3.00	3.50	3.50	Accelerate
<b>Beata Caranci</b> TD Bank Group	2.25	2.75	3.25	3.25	Maintain
<b>Edward A. Carmichael</b> Ted Carmichael Global Macro	2.25	3.00	3.50	4.00	Accelerate
<b>Michael Devereux</b> University of British Columbia	2.25	2.50	2.75	3.00	Maintain
<b>Stéfane Marion</b> National Bank of Canada	2.25	2.75	3.25	3.25	Maintain
<b>Angelo Melino</b> University of Toronto	2.25	2.75	3.00	3.00	Accelerate
<b>Douglas Porter</b> BMO Capital Markets	2.25	2.75	3.25	3.25	Maintain
<b>Avery Shenfeld</b> CIBC	2.25	2.75	3.00	3.00	Maintain
<b>Pierre Siklos</b> Wilfrid Laurier University	2.00	2.25	3.00	3.50	Maintain
<b>Stephen D. Williamson</b> Western University	2.00	2.25	2.50	2.50	Maintain
<b>Craig Wright</b> RBC	2.25	3.00	3.25	3.25	Maintain
<b>Median Vote</b>	2.25	2.75	3.25	3.25	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 September 1, 2022 prior to the Bank of Canada's interest rate announcement on September 7, 2022.

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