Monetary Policy Council

Communiqué

September 1, 2022

C.D. Howe Institute Monetary Policy Council Calls for Bank of Canada to Raise Overnight Rate to 3.25 Percent

September 1, 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 3.25 percent on September 7th, and maintain the current pace of 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 the planned reduction in its holdings of Government of Canada bonds.

Four of the seven members attending the meeting supported 3.25 percent target for the overnight rate at the upcoming announcement; the other three favoured a target of 3.00 percent. The call for the October announcement was more balanced, with four members supporting a target of 3.25 percent, while one favoured a target of 3.00 percent and two favoured a target of 3.50 percent. By March of 2023, the mean vote was somewhat higher, with three members favouring 3.25 percent, three favouring 3.50 percent, and one favouring 3.00 percent. In a year's time, however, the mean was lower again, with five members favouring 3.25 percent, one favouring 3.50 percent, and one favouring 3.00 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. Five of the seven members called for the Bank of Canada to maintain that schedule, while two called for the Bank to accelerate it, with a particular focus on eliminating its holdings of real return bonds.

The critical factor behind the MPC's consensus in favour of a substantial increase in the overnight rate target at the upcoming meeting was inflation running well above the 2 percent target. Members noted the pervasiveness of price pressures, including in various measures of core inflation and wages, and the wide gap between growth of nominal and real GDP, including in the latest numbers from the second quarter of 2022.

A key theme in the discussion, which explains the median vote for no further increase in the overnight rate target over the coming year, and the calls from two MPC members for a reduction in the target from its peak during the year, was the degree to which actions already taken by the Bank of Canada and many other central banks might already have set the stage for lower inflation. In this connection, members noted evidence of a slower US economy, declines in the prices of energy, food and metals from their recent highs, and slackening of activity and price pressures in the housing market.

In addition to the question of potential lags in the effects of monetary policy – both the loosening during the pandemic and the tightening since then – the group debated a number of factors. They included the increase in Canada's monetary aggregates during the loosening and the sharp slowdown in their growth rates since then, the quality of measures of tightness in the labour market and wage growth, and the credibility of central bankers, notably in the US Federal Reserve, with respect to reducing inflation. On balance, members favoured a continued front-loading of interest-rate increases, with a pause or reversal in prospect if inflation appears to be turning decisively down.

In connection with judging the direction of inflation, several members noted problems with commonly referenced measures of "core" inflation. The sizeable upward revisions to past readings of the Bank of Canada's CPI-common measure prompted criticisms of this measure, and some members noted that the focus on year-over-year readings of several measures was especially unhelpful when looking for evidence of turning points in price pressures.

Turning to the Bank of Canada's holdings of Government of Canada bonds, most members were comfortable with the Bank's intention to let its balance sheet shrink as the bonds mature. The key exception to this comfort related to the real return bonds – which, being indexed to the CPI, yield more when inflation is higher. A couple of members commented on the inappropriateness of the Bank gaining from inflation, and argued that, if only for optical reasons, the Bank should dispose of these bonds.

Votes of MPC Members and the Council Median for Each Announcement (*percent*)					
MPC Members	**Sept 7, 2022**	**Oct 26, 2022**	**Mar , 2023**	**Sept , 2023**	**Reduction in Bond Holdings**
Steve Ambler Université du Québec à Montréal (UQAM)	3.00	3.25	3.50	3.25	Accelerate
Michael Devereux University of British Columbia	3.25	3.50	3.50	3.25	Maintain
Stéfane Marion National Bank of Canada	3.25	3.25	3.25	3.25	Maintain
Angelo Melino University of Toronto	3.00	3.25	3.25	3.25	Accelerate
Avery Shenfeld CIBC	3.25	3.25	3.25	3.25	Maintain
Stephen D. Williamson Western University	3.00	3.00	3.00	3.00	Maintain
Craig Wright RBC	3.25	3.50	3.50	3.50	Maintain
Median Vote	3.25	3.25	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 October 20, 2022, prior to the Bank of Canada's interest rate announcement on October 26.

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