

December 1, 2022

C.D. Howe Institute Monetary Policy Council Calls for Bank of Canada to Raise Overnight Rate to 4.00 Percent and Accelerate Reduction in Bond Holdings

December 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 25 basis points to 4.00 on December 7, and sell some of its holdings of Government of Canada bonds. The Council also recommended that the Bank raise the overnight rate target to 4.25 percent in January 2023, and hold it there through 2023.

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 both the January and December 2023 recommendations, 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 accelerate, maintain or slow the planned reduction in its holdings of Government of Canada bonds.

The tie-breaking rounding of a split vote in the direction of the previous setting mattered for the Council’s vote on the upcoming setting, with six members favouring a 4.25 percent target for the overnight rate and six favouring a target of 4.00 percent. The vote for the January 2023 setting was clearer, with four members favouring 4.00 percent, five favouring 4.25 percent, and three favouring 4.50 percent. By June of 2023, members’ votes were evenly balanced in a range from 3.75 percent to 4.75 percent. By December of 2023, the range was wider: 3.50 percent to 5.00 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 Council members called for the Bank of Canada to maintain that schedule, while seven called for the Bank to accelerate it by selling some of its bonds ahead of their maturity dates.

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The MPC's consensus in favour of at least one more hike in the Bank of Canada's overnight rate target reflected broad-based inflation that is still well above the Bank's 2 percent target. Looking further ahead, however, the group's views diverged because of differing assessments about the momentum of inflation, the economic outlook globally and domestically, and the potential lagged impact of monetary tightening to date.

In looking at economic activity abroad, the main point of uncertainty highlighted in the discussion concerned the stringency and likelihood of success of China's lockdown measures to contain COVID-19. Domestically, MPC members debated the evidence that higher interest rates were affecting sectors of the economy that typically respond faster to changes in interest rates, particularly housing, and the strength of the labour market and consequent wage pressures. A number of members noted the likely lagged effects of tightening to date, citing the weakness of domestic demand in the third quarter. Although some members noted that the upcoming release of Labour Force Survey data might confirm a slackening in the pace of job growth, many argued that continued tightness in the labour market and efforts to catch up with consumer prices would likely keep wage pressures strong.

The MPC devoted considerable attention to indicators that might be signaling turning points, such as stocks of money, credit, and price indexes, stressing the potential importance of flagging growth rates over shorter periods than the 12-month rates of change that usually get the most attention. Several members argued that higher-frequency readings signaled that inflationary pressures were easing, and that the Bank of Canada should pause its rate hikes before long to assess the impact of its actions to date. The question of forward guidance in the Bank's announcement also got considerable attention, with some members arguing that past statements about maintaining or increasing rates had been too categorical, and that the Bank should emphasize conditionality if it makes such statements in the future.

On the subject of the Bank's balance sheet, a substantial minority of MPC members felt that the Bank should continue to let its bondholdings shrink as the bonds mature. Two considerations lay behind the majority vote for the Bank to sell bonds between its next announcement date and the following one in January: the fact that no Government of Canada bonds are maturing between the two dates; and a general easing of financial conditions, including a bond-market rally, since the last announcement, that was inconsistent with continued downward pressure on inflation.

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

MPC Members	Dec 7, 2022	Jan 25, 2023	Jun 7, 2023	Dec 6, 2023	Reduction in Bond Holdings
Steve Ambler Université du Québec à Montréal (UQAM)	4.00	4.00	3.75	3.50	Accelerate
Beata Caranci TD Bank Group	4.25	4.50	4.50	3.50	Maintain
Edward A. Carmichael Ted Carmichael Global Macro	4.25	4.50	4.75	4.75	Accelerate
Michael Devereux University of British Columbia	4.25	4.25	4.25	4.25	Accelerate
Stéfane Marion National Bank of Canada	4.00	4.00	4.00	3.75	Maintain
Angelo Melino University of Toronto	4.00	4.25	4.25	4.25	Accelerate
Jean-François Perreault Scotiabank	4.25	4.25	4.25	4.00	Accelerate
Douglas Porter BMO Capital Markets	4.25	4.50	4.50	4.50	Accelerate
Avery Shenfeld CIBC	4.25	4.25	4.25	4.25	Maintain
Pierre Siklos Wilfrid Laurier University	4.00	4.25	4.50	5.00	Accelerate
Stephen D. Williamson Western University	4.00	4.00	4.00	4.00	Maintain
Craig Wright RBC	4.00	4.00	4.00	4.00	Maintain
Median Vote	4.00	4.25	4.25	4.25	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 January 19, 2023, prior to the Bank of Canada's interest rate announcement on January 25.

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