Monetary Policy Council

Communiqué

January 19, 2023

C.D. Howe Institute Monetary Policy Council Calls for Bank of Canada to Hold Overnight Rate at 4.25 Percent

January 19, 2023 – The C.D. Howe Institute's **Monetary Policy Council** (MPC) recommends that the Bank of Canada hold its target for the overnight rate, its benchmark policy interest rate, at 4.25 percent on January 25th. The Council further recommended that the Bank raise the overnight rate target to 4.50 percent at the following announcement in March and hold it there through July before lowering it back to 4.25 percent by January of 2024.

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 for the upcoming setting, the recommendation is rounded in the direction of the previous setting.

The Council also offers a view on whether the Bank should accelerate, maintain or slow the planned reduction in its holdings of Government of Canada bonds. The majority voted for the Bank to maintain its planned pace of reduction.

The tie-breaking rounding of a split vote in the direction of the previous setting mattered for the Council's vote on the upcoming announcement, with four of the eight members attending the meeting favouring a 4.25 percent target for the overnight rate and four favouring a target of 4.50 percent. The vote for the March setting featured three members favouring 4.25 percent, four favouring 4.50 percent, and one favouring 4.75 percent. By July, the range had widened, with one member calling for a cut in the overnight rate to 4.00 percent and two calling for a further hike to 4.75 percent. By January of 2024, the range around the 4.25 percent median vote was wider yet, with two members calling for a rate of 3.75 percent and one calling for a rate of 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. Two Council members called for the Bank of Canada to accelerate the reduction by selling bonds between now and its next overnight rate announcement date, while the other six called for the Bank to maintain that schedule.

The even split in the MPC's votes on the upcoming overnight rate setting and the widening range around the median votes for future settings reflected a split in the group's views about how much more monetary restraint is needed to bring inflation back to target. In part, this split resulted from differing views about external factors, such as the impact of China's reopening from COVID and further pressure on food and energy prices from Russia's invasion of Ukraine. The bulk of the debate, however, was about the importance of indicators that monetary restraint is already having major impacts versus indicators of continued robustness of demand and persistence of inflation.

Among the indicators emphasized by the group favouring no further increases in the overnight rate target and cuts over the coming year were the sharp deceleration in the monetary aggregates, signs of flagging consumer demand and a weaker housing market. Among the indicators emphasized by the group favouring further hikes in the overnight rate were the fact that recent weakness in the monetary aggregates has not offset previous growth, and that the labour market remains tight. In discussing inflation, the former group cited recent lower-than-expected CPI numbers and flagging growth of nominal income, while the latter group cited increases in services prices, above-target inflation expectations among households and businesses, and the potential for further price shocks in food and energy to keep inflation high.

Although a strong majority of the group voted for the Bank of Canada to maintain its current policy of letting its bondholdings decline as the bonds mature, the discussion on this point was lively. A number of members noted that the bond-market rally over the past three months has eased financial conditions generally and kept mortgage rates down particularly, and that the Bank could underline its commitment to getting inflation back to target with bond sales. Other members noted that a sizeable amount of bonds will mature between now and the next announcement date, and some argued that nervousness over US fiscal and debt-management policy might make this a bad time to sell bonds.

Votes of MPC Members and the Council Median for Each Announcement (*percent*)					
MPC Members	**Jan 25, 2023**	**Mar 8, 2023**	**Jul 12, 2023**	**Jan 24, 2024**	**Reduction in Bond Holdings**
Steve Ambler Université du Québec à Montréal (UQAM)	4.25	4.25	4.00	3.75	Maintain
Edward A. Carmichael Ted Carmichael Global Macro	4.50	4.75	4.75	4.75	Accelerate
Stéfane Marion National Bank of Canada	4.25	4.25	4.25	3.75	Maintain
Angelo Melino University of Toronto	4.50	4.50	4.50	4.25	Maintain
Douglas Porter BMO Capital Markets	4.50	4.50	4.50	4.50	Accelerate
Pierre Siklos Wilfrid Laurier University	4.25	4.50	4.75	5.00	Maintain
Stephen D. Williamson Western University	4.25	4.25	4.25	4.25	Maintain
Craig Wright RBC	4.50	4.50	4.50	4.25	Maintain
Median Vote	4.25	4.50	4.50	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 March 2, 2023, prior to the Bank of Canada's interest rate announcement on March 8.

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