C.D. Howe Institute Monetary Policy Council Calls for Bank of Canada to Hold Overnight Rate at 4.50 Percent through October, Cut to 4.00 Percent by April of 2024

April 6, 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 4.50 percent on April 12th, and keep it at that level for the next six months. By April of 2024, the Council recommends a cut to 4.00 percent.

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 whether the Bank should accelerate, maintain or slow the planned reduction in its holdings of Government of Canada bonds. On this occasion, the majority voted for the Bank to maintain its planned pace of reduction.

A strong majority of Council members – eight of the 10 attending the meeting – voted for no change in the overnight rate target at the upcoming announcement and the June announcement. Two of the members wanted a hike to 4.75 next week, however, and by June, one of those members wanted a further hike to 5.00 percent. Divergence in views about the future path of inflation showed more clearly in the Council's votes for October, with five members favouring an overnight rate unchanged at 4.50 percent, two looking for 4.75 or 5.00 percent, and three looking for a cut to 4.25. By April of 2024, two members continued to recommend 4.75 or 5.00 percent, while the votes of the other eight ranged from 3.75 percent to 4.25 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. Three of the 10 Council members in attendance called for the Bank of Canada to accelerate the reduction, while the other seven called for the Bank to maintain its intended schedule.

In assessing the outlook for aggregate demand, Council members noted upgrades in growth forecasts overseas and indicators of robust activity, particularly in labour markets, in the United States and Canada. While expectations of a recession are widespread, several members commented that forecasters are calling for a later and less deep slump. The group noted the risks of further financial-system stresses following recent US and European bank failures, and possible tightening of credit. The tone of this discussion was generally relaxed, however, with some members noting that lower bond yields of late amounted to an easing of monetary conditions. Several members noted that Canadian governments, federal and provincial alike, were boosting demand inappropriately given the overheated state of the economy.

In looking at inflation, most members emphasized that the latest monthly numbers in Canada showed a marked deceleration, consistent with the Bank of Canada's forecast of a return to 2 percent CPI inflation by the end of 2024. The Council discussed inflation expectations at some length, including the contrast between elevated expectations in consumer and business surveys, and the much lower expectations inferable from bond yields. While some members were concerned about Canadians' inflation expectations having moved above the 2-percent target, others noted that consumer expectations have always been high, and are overly sensitive to short-term changes in gasoline prices. Another focus of discussion was wages, productivity and unit labour costs. Among members more concerned about persistent inflation, a number of quarters in a row of robust wage growth, falling productivity, and unit labour costs rising well above the inflation target suggested that the Bank of Canada should remain aggressive in restraining demand. While most members were concerned about low productivity growth, members favouring a less aggressive stance emphasized that estimates of hours worked are imprecise, and that ups and downs in wage growth tend to follow inflation rather than lead it.

On balance, these considerations inclined the group to expect that a softening economy would lead to continued declines in inflation toward target, thus explaining the majority vote in favour of holding the overnight rate steady into the fall and then reducing it. As for the pace of reduction in the Bank of Canada's bond holdings, advocates of acceleration argued that bond sales would temper the easing of financial conditions caused by falling bond yields, while other members were comfortable with the current pace, given their expectation of falling inflation. One member noted that the Bank could usefully mention its willingness to raise the overnight rate in the event that inflation proves more stubborn than expected.

Votes of MPC Members and the Council Median for Each Announcement (*percent*)					
MPC Members	**12 April, 2023**	**7 June, 2023**	**25 October, 2023**	**April 2024**	**Reduction in Bond Holdings**
Steve Ambler Université du Québec à Montréal (UQAM)	4.50	4.50	4.25	3.75	Maintain
Edward A. Carmichael Ted Carmichael Global Macro	4.75	5.00	5.00	5.00	Accelerate
Michael Devereux University of British Columbia	4.50	4.50	4.25	4.00	Maintain
Angelo Melino University of Toronto	4.50	4.50	4.50	4.00	Accelerate
Jean-François Perrault Scotiabank	4.50	4.50	4.50	4.00	Maintain
Douglas Porter BMO Capital Markets	4.50	4.50	4.50	4.00	Accelerate
Avery Shenfeld CIBC	4.50	4.50	4.50	4.25	Maintain
Pierre Siklos Wilfrid Laurier University	4.75	4.75	4.75	4.75	Maintain
Stephen D. Williamson Western University	4.50	4.50	4.25	4.00	Maintain
Craig Wright RBC	4.50	4.50	4.50	4.00	Maintain
Median Vote	4.50	4.50	4.50	4.00	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 June 1, 2023, prior to the Bank of Canada's overnight rate announcement on June 7.

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