

February 29, 2024

C.D. Howe Institute Monetary Policy Council Calls for Bank of Canada to Hold Overnight Rate at 5.00 Percent, Cut to 3.50 Percent by March of 2025

February 29, 2024 – The C.D. Howe Institute’s **Monetary Policy Council** (MPC) recommends that the Bank of Canada maintain its target for the overnight rate, its benchmark policy interest rate, at 5.00 percent at its next announcement on March 6th. The MPC further recommends that the Bank keep the target at 5.00 percent in April, before reducing it to 4.50 percent by September and to 3.50 percent by March of 2025.

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, although in this instance it was chaired by **Jeremy Kronick**, the Institute’s Associate Vice President and Director of the Centre on Financial and Monetary Policy. 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 call for an unchanged overnight rate target next week was almost unanimous, with eight of the 10 MPC members attending the meeting calling for a target of 5.00 percent, while two voted for a reduction to 4.75. For the April setting, one member voted for a reduction to 4.50 and one voted for 4.75, with the remaining eight voting for an unchanged target of 5.00 percent. By September, all 10 MPC members voted to lower the target, within a range of 4.00 to 4.75 percent. By March of 2025, with all members voting for a lower overnight rate, the range of recommendations was from 3.00 to 4.50 percent (see table below).

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 Bank of Canada’s current policy is to buy nothing and let its holdings shrink as the bonds mature. Members discussed the fact that the overnight rate has been above the target of late and whether this implied the Bank should slow or stop quantitative tightening. Nine of the 10 members attending the meeting called for the Bank to maintain its schedule between now and its overnight-rate announcement in April. The remaining member called for the Bank to slow it – buying bonds to replace at least part of those that will mature. Some members who had called for the Bank to maintain its schedule did call on the Bank to end quantitative tightening at its next meeting in April. One member called for the Bank to sell its real-return bonds.



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Both Canadian and US GDP data were released just before the meeting of the MPC. Members discussed the notable differences between the two countries. The US economy continues its resilience, once again overshooting expectations, with reductions in inflation due to a combination of rate hikes and productivity gains. While the Canadian economy performed above expectations in Q4 2023, the underlying story was less impressive. Business investment continued to be weak, loan-loss provisions increased, and the growth that did occur came mostly from exports to the US. Members highlighted the Canadian housing market as it starts to rebound, as well as concerns about fiscal policy as we enter budget season both at the federal and provincial levels. Both could act as a further stimulus to buoy the Canadian economy, pushing out Bank of Canada rate cuts.

Members discussed other factors that might slow the pace of future cuts to the overnight rate target. Wage growth continues to be strong, even as job vacancy rates shrink back to a more normal equilibrium. Core inflation remains sticky, driven by services inflation. At the Bank's previous announcement, it discussed the Canadian economy operating in modest excess supply. Members discussed the difficulty in calculating the output gap given the fast-paced population growth Canada has experienced recently. As rate cuts eventually begin, members raised the question as to where the equilibrium overnight rate might be – the so-called neutral rate – highlighting its importance but also the complexity in deciding what that level is, given the multitude of factors involved in the calculation.

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

| MPC Members | 6 March, 2024 | 10 April, 2024 | 4 Sept, 2024 | March, 2025 | Reduction in Bond Holdings |
|---|---------------|----------------|--------------|-------------|----------------------------|
| Steve Ambler Université du Québec à Montréal (UQAM) | 4.75 | 4.75 | 4.25 | 3.50 | Maintain |
| Beata Caranci TD Bank Group | 5.00 | 5.00 | 4.25 | 3.25 | Maintain |
| Ted Carmichael Ted Carmichael Global Macro | 5.00 | 5.00 | 4.75 | 4.50 | Maintain |
| Stéfane Marion National Bank of Canada | 5.00 | 5.00 | 4.50 | 3.00 | Maintain |
| Angelo Melino University of Toronto | 5.00 | 5.00 | 4.50 | 3.75 | Maintain |
| Luba Peterson Simon Fraser University | 5.00 | 5.00 | 4.50 | 3.50 | Maintain |
| Doug Porter BMO Capital Markets | 5.00 | 5.00 | 4.50 | 4.00 | Maintain |
| Avery Shenfeld CIBC | 5.00 | 5.00 | 4.25 | 3.50 | Maintain |
| Stephen Williamson Western University | 4.75 | 4.50 | 4.00 | 3.50 | Maintain |
| Craig Wright RBC | 5.00 | 5.00 | 4.50 | 4.00 | Slow |
| Median Vote | 5.00 | 5.00 | 4.50 | 3.50 | Maintain |

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. Forecasters' recommendations may differ from their predictions.

The MPC's next vote will take place on April 4, 2024, prior to the Bank of Canada's overnight rate announcement on April 10.

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