Bank of Canada Should Hold Overnight Rate at 1.75 Percent through July, Cut to 1.50 by Next Year: C.D. Howe Institute Monetary Policy Council

January 16, 2020 – The C.D. Howe Institute's **Monetary Policy Council** (MPC) recommends that the Bank of Canada keep its target for the overnight rate, its benchmark policy interest rate, at 1.75 until July 2020. 1.75 percent was the median vote of the nine members attending the meeting, and is the Council's formal recommendation. By January of 2021, with four members calling for a cut in the target at some point, and three calling for an increase, the Council's median recommendation was 1.50.

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 President and CEO, chairs the Council. Council members make recommendations for the Bank of Canada's upcoming policy rate announcement, the subsequent announcement, and the announcements six months and one year ahead.

Seven of the nine members attending this meeting called for the Bank to maintain the overnight rate target at 1.75 percent next week, while two called for the Bank to lower it to 1.50 percent. Looking ahead to the next announcement on March 4th, six called for a target of 1.75 percent, two for a target of 1.50 percent, and one for a target of 1.25 percent. By July, the distribution of calls had shifted, with five favouring 1.75 percent, two favouring 1.50 percent, and two favouring 1.25 percent. By January 2021, the distribution had widened, with three members favouring an increase to 2.00 percent, one favouring 1.75 percent, three favouring 1.50 percent and two favouring 1.25 percent, which shifted the median vote down to 1.50 percent (see table).

The preponderance of calls for no change in the Bank of Canada's overnight rate target in the coming weeks, and the fact that some members called for a higher target in a year's time, while others called for a lower one, reflect offsetting factors in the MPC's assessment. Relative to MPC meetings in late 2019, members took a somewhat more positive view of the global outlook, offset by a somewhat less positive view of the domestic situation, resulting in a fine balance regarding the outlook for the Canadian economy and inflation

Looking abroad, members noted declining fears of recession in the United States, and indicators of a pickup in activity overseas. Notwithstanding uncertainty over details, they cited easing US-China trade tensions and greater clarity about Brexit as contributors to the improved tone of the world economy.

Looking domestically, members devoted particular attention to Canada's labour market. They noted robust employment and wage numbers, contrasting with weaker indicators of hours worked. Some members emphasized the difficulty of drawing strong conclusions about the tightness of the market given strong immigration-driven growth in the population of labour-force age. Others observed the contrast between recent weakness in consumer confidence, and positive sentiment among job-holders.

The state of business confidence and implications for capital spending was also a focus of conversation. Members debated the mixed signals and significance of various surveys. In general, the tone of the

conversation was sober, with members generally agreeing that weak business investment was a key driver of weak productivity growth – which, in turn, means that relatively tepid growth in activity presses up more quickly against the economy's productive capacity.

On balance, the group felt that the outlook for activity and inflation justified little or no change in the overnight-rate target in the near term. Additional reasons for caution cited by various members were the need to avoid subjecting indebted households to higher interest payments, the potential adverse consequences of a higher foreign exchange rate, and the uneven geographic and sectoral mix of growth in Canada. Political concerns about the US election were an additional concern that helped tip the MPC's median vote to a cut at the beginning of 2021.

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

MPC Members	Jan 22	Mar 4	Jul 15	Jan 2021
Steve Ambler Université du Québec à Montréal (UQAM)	1.75	1.75	1.75	1.75
Edward A. Carmichael Ted Carmichael Global Macro	1.50	1.25	1.25	1.25
Michael Devereux University of British Columbia	1.75	1.75	1.75	2.00
Thorsten Koeppl Queen's University	1.75	1.75	1.75	2.00
Stéfane Marion National Bank of Canada	1.75	1.75	1.75	2.00
Angelo Melino University of Toronto	1.50	1.50	1.50	1.50
Jean-François Perreault Scotiabank	1.75	1.50	1.25	1.25
Avery Shenfeld CIBC	1.75	1.75	1.50	1.50
Pierre Siklos Wilfrid Laurier University	1.75	1.75	1.75	1.50
Median Vote	1.75	1.75	1.75	1.50

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 February 27, 2020 prior to the Bank of Canada's interest rate announcement on March 4, 2020.

* * * * *

Contact: Kristine Gray – phone: 416-865-1904; e-mail: **kgray@cdhowe.org.**