Monetary Policy Council

Communiqué

June 3, 2021

Bank of Canada Should Keep Overnight Rate at 0.25 Percent over Coming Year: C.D. Howe Institute Monetary Policy Council

June 3, 2021 – 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 0.25 percent at least until June of 2022, but reduce its purchases of Government of Canada bonds from the current pace of $3 billion per week.

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. At recent MPC meetings, members have also voted on the Bank's quantitative easing program.

All 11 members of the MPC attending this meeting called for the Bank to hold the overnight rate target at 0.25 percent at its June 9th announcement. Ten of the 11 called for the Bank to hold the target at 0.25 percent, and one called for a target of 0.50 percent, at its July 14th announcement. By December, seven members called for a target of 0.25 percent, one for 0.50 percent, two for 0.75 percent, and one for 1.00 percent. By June of 2022, the median vote was still 0.25 percent, but the recommendations were strongly skewed upward: six members called for a target of 0.25 percent, with the other five calling for targets ranging from 0.50 percent to 2.00 percent (see table below). Nine of the 11 members voted for the Bank to reduce the pace of its bond purchases below $3 billion, while two voted for the Bank to maintain the $3 billion pace; no one called for an increase.

The MPC's discussion of economic activity around the world and in Canada highlighted many positive developments, notably upward revisions of growth forecasts and strength in cyclical indicators such as commodity prices. The boost that higher export prices have given Canada's terms of trade and Canadian incomes, with positive implications for spending in the second half of the year, was a particular focus. Although COVID-19 continues to preoccupy forecasters, the emphasis of the MPC's discussion about the coronavirus was less about its implications for spending and overall growth, and more about its sectoral impacts – in particular, the challenges it creates for attempts to measure the level of activity relative to productive potential. A number of MPC members highlighted the continuing role of fiscal supports in propelling spending, with some noting that fiscal policy worldwide might be pushing aggregate demand ahead of aggregate supply.

The challenges related to judging overall slack in the economy came to the fore in the MPC's discussion of the outlook for inflation. Many members emphasized the role of capacity constraints and other specific factors in particular markets, noting that inflation-targeting central banks have often successfully accommodated first-round effects of even large negative supply shocks, while ensuring that inflation expectations and the trend rate of inflation did not rise. Others noted that indicators of inflation that are less influenced by sector-specific developments have risen, as have inflation forecasts. The possibility that the US Federal Reserve is steering a more inflationary course than it has in the past came up repeatedly in the group's discussion of the magnitude and timing of the Bank of Canada's return to a more normal level of the policy rate. While members of the group were generally comfortable with the Canadian dollar's recent appreciation, several mentioned further increases in the exchange rate as a potential constraint on the Bank's ability to raise the overnight rate.

Notwithstanding the reluctance of many members to endorse an increase in the overnight rate target over the next 12 months, a strong majority recommended that the Bank of Canada reduce its pace of purchases of Government of Canada bonds to less than $3 billion per week. While two members felt that another reduction so soon after the Bank had reduced its purchases from at least $4 billion to $3 billion was premature, most members felt that the need for such support of the bond market is behind us, and several noted that the Bank of Canada should not play, or be seen to play, such a prominent role in financing the federal government's borrowing.

Votes of MPC Members and the Council Median for Each Announcement (*percent*)					
MPC Members	**Jun 9, 2021**	**Jul 14, 2021**	**Dec 8, 2021**	**Jun 2022**	**Vote on QE (*$billions/week*)**
Steve Ambler Université du Québec à Montréal (UQAM)	0.25	0.25	0.75	1.00	Less than $3B
Edward A. Carmichael Ted Carmichael Global Macro	0.25	0.50	1.00	2.00	Less than $3B
Michael Devereux University of British Columbia	0.25	0.25	0.75	1.00	Less than $3B
Stéfane Marion National Bank of Canada	0.25	0.25	0.25	0.25	Less than $3B
Angelo Melino University of Toronto	0.25	0.25	0.25	0.25	$3B
Jean-François Perrault Scotiabank	0.25	0.25	0.25	0.25	Less than $3B
Douglas Porter BMO Capital Markets	0.25	0.25	0.25	0.25	$3B
Avery Shenfeld CIBC	0.25	0.25	0.25	0.25	Less than $3B
Pierre Siklos Wilfrid Laurier University	0.25	0.25	0.25	0.25	Less than $3B
Stephen D. Williamson Western University	0.25	0.25	0.50	1.00	Less than $3B
Craig Wright RBC	0.25	0.25	0.25	0.50	Less than $3B
Median Vote	0.25	0.25	0.25	0.25	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 July 8, 2021 prior to the Bank of Canada's interest rate announcement on July 14, 2021.

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