Bank of Canada Should Hold Overnight Rate at 0.50 Percent Next Week; Hike to 1.00 Percent by April 2018: C.D. Howe Institute Monetary Policy Council

April 6, 2017 – The C.D. Howe Institute's **Monetary Policy Council** (MPC) today called for the Bank of Canada to keep its target for the overnight rate, the very short-term interest rate it targets for monetary policy purposes, at 0.50 percent at its next announcement on April 12, 2017. Looking ahead, the Council said the Bank should raise the target to 0.75 percent over the next six months, and to 1.00 percent by April of 2018.

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 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 the members attending the meeting.

All eleven of the MPC members attending this meeting called for an overnight rate target of 0.50 percent at the upcoming setting. For the May setting, 10 members called for 0.50 percent and one member for 0.75 percent. For the setting six months out, four called for a target of 0.50 percent, five called for 0.75 percent, and two called for 1.00 percent. For one year out, three called for 0.75 percent, seven for 1.00 percent, and one for 1.25 percent (see table below).

The dominant theme in the MPC's discussion was growing confidence in the robustness of economic expansion. Looking overseas, Council members noted important geopolitical uncertainties, but saw an improving economic picture. Looking at the United States, members also expressed policy-related concerns and noted a handful of disappointing recent economic indicators, but in an overall context of positive sentiment and a buoyant labour market.

The theme of more robust expansion carried through to the Canadian economy. Notwithstanding recent disappointing trade figures and continuing weakness in business investment, the group noted that both real and nominal gross domestic product are accelerating, and that Canada's disinflationary output gap must be shrinking. This was the backdrop for the group's desire to see the overnight-rate target rise over the coming year.

Reluctance to call for an increase in the target rate right away reflected some important uncertainties.

The state of the housing market, and the dramatic price increases in the Greater Toronto Area in particular, was a major focus of discussion. Many members of the group thought that non-monetary-policy measures to cool the market are necessary and/or likely. But uncertainty about the nature and impact of those measures, along with more fundamental disagreements about the priority the Bank of Canada should give the housing sector in setting monetary policy, meant that these considerations had limited weight in the MPC's overnight rate call.

Mixed labour-market indicators were also a major issue in many Council members' minds, especially since the meeting was occurring the day before major employment-related data releases in both Canada and the United States. While most measures are strong, hours worked have been weak, and wage increases remain subdued, complicating efforts to estimate how much slack exists in the job market.

For some members, the possible impact of an increase in the overnight rate target on the external value of the Canadian dollar was a concern. In their view, policy-rate hikes in Canada should come after and be smaller than policy-rate hikes in the United States, to avoid an appreciation of the dollar that might hurt Canada's external trade balance.

A final area of uncertainty, and a critical one, was inflation and inflation expectations. Council members generally felt that the improving economic outlook was consistent with the two percent inflation target, and warranted a more normal level for the overnight rate. Mixed signals on this front, notably weakness in some indicators of inflation expectations and in "core" measures of inflation, however, made many members advise that the Bank of Canada should not move until inflation is more unambiguously on track for two percent.

Votes of MPC Members and the Council Median for Each Announcement (*percent*)				
MPC Members	**Apr 12**	**May 24**	**Oct 2017**	**Apr 2018**
Steve Ambler Université du Québec à Montréal (UQAM)	0.50	0.50	0.75	1.00
Beata Caranci TD Bank Group	0.50	0.50	0.50	0.75
Edward A. Carmichael Ted Carmichael Global Macro	0.50	0.50	0.75	0.75
Michael Devereux University of British Columbia	0.50	0.50	0.75	1.00
Thor Koeppl Queen's University	0.50	0.50	0.75	1.00
Angelo Melino University of Toronto	0.50	0.50	0.50	1.00
Douglas Porter BMO Capital Markets	0.50	0.75	1.00	1.00
Nicholas Rowe Carleton University	0.50	0.50	0.75	1.00
Avery Shenfeld CIBC	0.50	0.50	0.50	1.00
Pierre Siklos Wilfrid Laurier University	0.50	0.50	1.00	1.25
Craig Wright RBC	0.50	0.50	0.50	0.75
Median Vote	0.50	0.50	0.75	1.00

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 May 18, 2017 prior to the Bank of Canada's interest rate announcement on May 24, 2017.

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