

July 5, 2018

Bank of Canada Should Raise Overnight Rate to 1.50% Next Week, Hike to 2.00 in a Year's Time

July 5, 2018 — The C.D. Howe Institute's **Monetary Policy Council** (MPC) called for the Bank of Canada to raise its target for the overnight rate, its benchmark policy interest rate, to 1.50 percent at its next announcement on July 11, 2018. Looking further ahead, the Council called for the Bank to hold the target at 1.50 percent in September, with further increases raising it to 2.00 percent by July of 2019.

The MPC provides an independent assessment of the monetary stance consistent with the Bank of Canada's 2 percent inflation target. **Jeremy Kronick**, an Associate Director, Research at the C.D. Howe Institute chaired the 120th Council's meeting. 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 but one of the nine MPC members who attended this meeting called for an overnight rate target higher than the current one at the upcoming meeting on Wednesday 11 July (see table). The near unanimity reflected the group's view that Canadian economic data in the second quarter have rebounded from a sluggish beginning to 2018. Output has risen since April, with the Business Outlook Survey suggesting we are at or above productive capacity. The labour market is also showing signs of tightening with growth in average hourly earnings at its highest level since 2008. The housing market continues to stabilize following policy changes enacted at the start of 2018. Furthermore, the latest CPI data have headline inflation, and two of the Bank's three core CPI measures above the two percent target. Lastly, the call for an interest rate hike was also bolstered by strong US economic data, and the potential spillover to the Canadian economy.

Notwithstanding the near-consensus for a higher target at the upcoming meeting, there was concern over geopolitical risks and significant uncertainty on the trade front. Members highlighted the fact that the Business Outlook Survey was taken prior to US tariffs on steel and aluminum, and before the worsening rhetoric on potential auto tariffs. All-out trade wars, whether they include Canada or not, would create negative spillovers for the Canadian economy. This uncertainty, however, was not enough to sway the vote for next week's meeting, but it did lead to caution as members looked ahead to the September meeting.

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Several Council members noted other reasons for caution in the near term. Increases in oil prices, despite their rebound and resulting upward pressure on inflation, have largely been supply driven, less reflective of a strengthening economy. Growth in monetary aggregates continues to slow. And, lastly, the most recent employment and trade data have yet to be released, coming out just prior to next week's meeting. Under those circumstances, members felt that Governing Council would be prudent to leave rates steady following next week's rate hike.

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

MPC Members	July 7	Sept 2018	Jan 2019	July 2019
Steve Ambler Université du Québec à Montréal (UQAM)	1.50	1.50	1.75	2.25
Beat Caranci TD Bank Group	1.50	1.50	1.75	1.75
Micahel Devereux University of British Columbia	1.50	1.50	1.75	2.00
Stéfane Marion National Bank Financial	1.25	1.25	1.50	1.75
Angelo Melino University of Toronto	1.50	1.50	1.75	2.25
Doug Porter BMO Capital Markets	1.50	1.50	1.75	2.00
Avery Shenfeld CIBC	1.50	1.50	1.75	1.75
Pierre Siklos Wilfrid Laurier University	1.50	1.50	1.75	2.00
Craig Wright RBC	1.50	1.50	1.75	2.25
Median Vote	1.50	1.50	1.75	2.00

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 August 30, 2018 prior to the Bank of Canada's interest rate announcement on September 5, 2018.

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