Bank of Canada Should Hold Overnight Rate at 1.75 Percent through January, Hike to 2.25 in a Year's Time Says C.D. Howe Institute Monetary Policy Council

November 29, 2018 – The C.D. Howe Institute's **Monetary Policy Council** (MPC) called for the Bank of Canada to keep its target for the overnight rate, its benchmark policy interest rate, at 1.75 percent at its next announcement on December 5, 2018, and in January of 2019. The MPC called for the target to rise to 2.00 percent by May 2019, and 2.25 percent by the end of next year.

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.

The call for maintaining the overnight rate next week was unanimous. By January, four of the ten members attending the meeting called for an increase in the overnight rate to 2.00, with the other six favouring maintaining it at 1.75 percent. Looking ahead to May 2019, the balance shifted decisively, with one member calling for a rate of 1.75 percent, six for a rate of 2.00 percent, and three for a rate of 2.25 percent. By December 2019, the votes were: one for 2.00 percent, five for 2.25 percent, and four for 2.50 percent (see table).

The MPC's consensus in favour of a higher overnight rate in a year's time reflects a judgement that the "neutral" policy interest rate – the rate that would be consistent with activity growing in line with the economy's productive capacity and inflation steady at 2 percent – is higher than the Bank of Canada's current target. But the 2.25 median call for the overnight rate by next December is low by comparison with longer-term history, and the preferred path for getting to it is slow – reflecting repeated disappointments with regard to both growth and below-target inflation over the past decade, and a number of uncertainties about the course of the Canadian economy in the coming months.

For many MPC members, a critical concern in the near and medium term was the ebbing of global growth and weakness in demand and prices for key Canadian natural resource products, exacerbated by the obstacles to getting oil to customers, the large discounts for Canadian producers, and consequent declines in output. Several members noted that lower prices and volumes for Canadian exports would depress national income in the coming quarters, with adverse effects for business and government revenues.

The discussion also focused on the threat of further disruptions to international trade, with US-China tensions getting the most attention, and the uncertain prospects for the USMCA and Brexit also getting mentions.

Looking at domestic demand in Canada, the MPC also noted that recent news has been on the soft side. Although consumer credit has been growing strongly, mortgage lending has levelled off with housing activity, and the announcement that GM will close its Oshawa plant signifies that the auto cycle is past its peak. While some members thought that the federal government's recent announcement of accelerated capital cost allowances will help at the margin, they emphasized that businesses are shifting to a defensive stance: the forecasters in the group said they had not revised their projections of business investment up appreciably.

Vitally important in assessing the appropriate stance for the Bank of Canada in the months ahead is the tension between measures that show an economy running at or even ahead of its productive capacity, and CPI inflation that – while currently ahead of target – is likely to slip back below it as the impact of higher energy prices falls out of the year-over-year measure. The contrast between a reasonably robust labour market and anemic wage gains was a particular focus. Along with the problems affecting the energy sector and global risks, subdued inflation was a key factor leading the group to recommend no overnight rate increase at the Bank of Canada's next two announcements.

Votes of MPC Members and the Council Median for Each Announcement (*percent*)				
MPC Members	**Dec 5**	**Jan 9**	**June 2019**	**Dec 2019**
Steve Ambler Université du Québec à Montréal (UQAM)	1.75	1.75	2.00	2.25
Beata Caranci TD Bank Group	1.75	1.75	2.00	2.25
Edward A. Carmichael Ted Carmichael Global Macro	1.75	1.75	1.75	2.00
Michael Devereux University of British Columbia	1.75	1.75	2.00	2.25
Thorsten Koeppl Queen's University	1.75	1.75	2.25	2.50
Stéfane Marion National Bank Financial	1.75	2.00	2.00	2.50
Angelo Melino University of Toronto	1.75	2.00	2.00	2.50
Jean-François Perrault Scotiabank	1.75	2.00	2.25	2.50
Doug Porter BMO Capital Markets	1.75	1.75	2.00	2.25
Avery Shenfeld CIBC	1.75	2.00	2.25	2.25
Median Vote	1.75	1.75	2.00	2.25

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 January 3, 2019 prior to the Bank of Canada's interest rate announcement on January 9, 2019.

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