

February 27, 2020

Bank of Canada Should Cut Overnight Rate to 1.50 Percent Next Week and to 1.25 in April: C.D. Howe Institute Monetary Policy Council

February 27, 2020 – The C.D. Howe Institute’s **Monetary Policy Council** (MPC) recommends that the Bank of Canada lower its target for the overnight rate, its benchmark policy interest rate, to 1.50 percent next week. The MPC further recommends that the Bank cut again at its next announcement in April, to 1.25 percent, and hold the target there until early 2021.

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.

Seven of the ten members attending this meeting called for the Bank to lower the overnight rate target to 1.50 percent next week, while the other three called for no change. Looking ahead to the April announcement, six of the members called for a target of 1.25 percent, and four for a target of 1.50 percent. For six months out, the centre of gravity of the recommendations shifted down slightly further, with one member calling for 1.00 percent, six for 1.25 percent, and three for 1.50 percent. By March of 2021, one member called for 1.00 percent, five for 1.25 percent, and four for 1.50 percent (see table).

The principal focus of the MPC’s discussions, and the reason for the downward tendency in the group’s calls for the overnight-rate target over the next six months, was the potential impact of Covid-19, the corona virus, on the global and Canadian economies. Most members emphasized its negative implications for demand, citing sharp declines in equity markets and commodity prices, and downgraded forecasts for growth in many Asian and European economies. At this point, it is impossible to know how large and long-lasting these effects will be, but their implications for Canadian exports and consumer and business confidence are clearly negative. Several MPC members emphasized that financial market participants expect central banks to cut their policy rates – an expectation reflected in declining longer-term interest rates – and that the Bank of Canada should validate that expectation.

A countervailing theme in the comments of many members was downgrades in their assessments of the Canadian economy’s potential growth rate. Negative supply-side impacts of Covid 19 were a consideration here. So were Canada’s recently demonstrated vulnerability to transportation disruptions. Several members cited continued evidence, exemplified by Teck Resources’ cancellation of its Frontier oil sands project and captured in a weak capital and repair expenditure survey from Statistics Canada this morning, of weak business investment, with ominous implications for future productivity growth. In the near term, some members noted that slower potential growth implies a smaller output gap, and thus less room for policy rate cuts, than would be the case otherwise. Looking further out, however, slower potential growth would lower the level of the policy rate that is consistent with steady growth and 2 percent inflation.

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Further tempering influences on the group's overall desire for a lower overnight rate target over time was the current strength of the Canadian housing market, and solid growth of employment and wages. Combined with the possibility that some factors contributing to weak growth in late 2019 and early 2020 were temporary, the group tended to feel that the Bank of Canada need not cut more than 25 basis points next week, and that it could await confirmation of some of the negative influences from abroad before cutting further.

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

MPC Members	March 4	April 15	September 9	March 2021
Steve Ambler Université du Québec à Montréal (UQAM)	1.50	1.25	1.25	1.25
Beata Caranci TD Bank Group	1.75	1.50	1.50	1.50
Edward A. Carmichael Ted Carmichael Global Macro	1.50	1.25	1.00	1.00
Michael Devereux University of British Columbia	1.50	1.25	1.25	1.25
Thorsten Koepl Queen's University	1.50	1.25	1.25	1.50
Stéfane Marion National Bank of Canada	1.50	1.25	1.25	1.25
Angelo Melino University of Toronto	1.50	1.50	1.50	1.50
Jean-François Perreault Scotiabank	1.50	1.25	1.25	1.25
Pierre Siklos Wilfrid Laurier University	1.75	1.50	1.25	1.25
Craig Wright RBC	1.75	1.50	1.50	1.50
Median Vote	1.50	1.25	1.25	1.25

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 April 9, 2020 prior to the Bank of Canada's interest rate announcement on April 15, 2020.

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