

October 19, 2023

## C.D. Howe Institute Monetary Policy Council to Bank of Canada: Hold Overnight Rate at 5.00 Percent until Early 2024, Cut to 4.50 Percent by Next October

October 19, 2023 – The C.D. Howe Institute’s **Monetary Policy Council** (MPC) recommends that the Bank of Canada maintain its target for the overnight rate, its benchmark policy interest rate, at 5.00 percent on October 25<sup>th</sup>. The MPC further recommends that the Bank keep the target at 5.00 percent at least until April of 2024, then reduce it to 4.50 percent by October of 2024.

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, though in this instance it was chaired by **Jeremy Kronick**, the Institute’s Associate Vice President and Director of the Centre on Financial and Monetary Policy. 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.

There was unanimity in favour of maintaining the target in the near term as all ten members attending the meeting called for a target of 5.00 percent on October 25<sup>th</sup>. All but one member voted to keep the target at 5.00 percent at the following setting on December 6<sup>th</sup>, with the remaining member voting for a decrease to 4.75 percent. By April of 2024, while the median vote remained at 5.00 percent, there was a shift in sentiment with six members calling for a target of 5.00 percent, two calling for 4.75 percent, one for 4.50 percent, and one for 4.25 percent. In a year’s time, only two members voted to keep the target at 5.00 percent, with the rest all voting to lower the target: one to 4.75 percent, three to 4.50 percent, two to 4.25 percent, and one to 4.00 percent, yielding a median recommendation of 4.50 percent (see table below).

The Council also offers a view on whether the Bank should accelerate, maintain or slow the planned reduction in its holdings of Government of Canada bonds. The Bank of Canada’s current policy is to buy nothing and let its holdings shrink as the bonds mature. Nine of the ten members attending the meeting called for the Bank to maintain that schedule, while the remaining member called for it to accelerate the reduction in its holdings.

The group’s recommendation for no change in the overnight rate at the upcoming setting, and a steady pace over the next six months was due to a number of considerations. Members noted uncertainty on the global economic outlook stemming from recent events in the Middle East. Here in Canada, members highlighted increased signs that economic activity was slowing, and that inflation, which typically lags

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behind, is likely to follow. Members emphasized signs that the latter has begun including downward pressure on core inflation, the disappearance of goods inflation – though services inflation remains sticky – and inflation measures that strip away shelter costs getting close to target.

Members also highlighted weak business investment and productivity – in contrast to the US – as well as a housing market that, despite rebounding in the middle of this tightening cycle, has started to weaken once again. The increased number of households renewing their mortgages at much higher rates is starting to weigh on consumption, feeding through to economic activity, which will put downward pressure on price growth.

The impact of immigration continued to be a theme for the group. Members highlighted the fact that large increases in population growth have both a demand and supply element to their impact on economic activity and inflation. Increased demand from a surge in new residents has created an imbalance in the housing market, and has led to an outsized increase in rent relative to headline CPI. Over time, however, members pointed out that increased immigration should increase the potential of the economy.

Lastly, members discussed the labour market cooling and slowing price growth of input costs. However, businesses might be cautious to pass through these changes as recent survey data suggests wage expectations remain elevated.

These issues help explain why, despite a weakening economy, MPC members voted to keep the target at 5.00 percent and did not vote to lower the target until at least six months out.

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<b>Votes of MPC Members and the Council Median for Each Announcement (<i>percent</i>)</b>					
<b>MPC Members</b>	<b>25 October, 2023</b>	<b>6 December, 2023</b>	<b>10 April, 2024</b>	<b>23 October, 2024</b>	<b>Reduction in Bond Holdings</b>
<b>Steve Ambler</b> Université du Québec à Montréal (UQAM)	5.00	5.00	4.50	4.00	Maintain
<b>Beata Caranci</b> TD Bank Group	5.00	5.00	4.75	4.25	Maintain
<b>Ted Carmichael</b> Ted Carmichael Global Macro	5.00	5.00	5.00	5.00	Maintain
<b>Michael Devereux</b> University of British Columbia	5.00	5.00	4.75	4.50	Maintain
<b>Stéfane Marion</b> National Bank of Canada	5.00	5.00	5.00	4.50	Maintain
<b>Angelo Melino</b> University of Toronto	5.00	5.00	5.00	4.50	Accelerate
<b>Luba Petersen</b> Simon Fraser University	5.00	5.00	5.00	5.00	Maintain
<b>Doug Porter</b> BMO Capital Markets	5.00	5.00	5.00	4.75	Maintain
<b>Stephen Williamson</b> Western University	5.00	4.75	4.25	4.00	Maintain
<b>Craig Wright</b> RBC	5.00	5.00	5.00	4.25	Maintain
<b>Median Vote</b>	5.00	5.00	5.00	4.50	Maintain

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. Forecasters' recommendations may differ from their predictions.

The MPC's next vote will take place on November 30, 2023, prior to the Bank of Canada's overnight rate announcement on December 6.

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