

February 28, 2019

## Bank of Canada Should Hold Overnight Rate at 1.75 Percent through September, Hike to 2.00 in a Year's Time Says C.D. Howe Institute Monetary Policy Council

February 28, 2019 – 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 March 6, 2019 and hold it there through to September 4, 2019. The MPC called for the target to rise to 2.00 percent by March 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.

All ten members attending the meeting supported keeping the overnight rate at 1.75 percent next week, and nine of the 10 supported keeping it at 1.75 at the next announcement in April. By September, seven supported keeping the rate at 1.75, with the other three favouring raising it to 2 percent. By March of 2020, the members' recommendations ranged from a low of 1.50 percent to a high of 2.50 percent (see table).

A key theme in the MPC's recent discussions has been the possibility that the "neutral" overnight rate – the level that would be consistent with activity growing in line with the economy's productive capacity and 2 percent inflation – is lower than historically, and lower than many recent estimates, including those at the Bank of Canada. Although the neutral rate ought to be positive in real terms – that is, higher than 2 percent inflation – many members at this meeting emphasized their desire to see how the economy evolves with the overnight rate where it is before raising it further.

Among the factors influencing the timing – and in one instance, the direction – of members' recommendations for changes in the overnight rate was the external environment. On the negative side, members mentioned slowing global growth and continued uncertainty about how the US Congress and Administration will deal with the Canada-US-Mexico Agreement, or NAFTA. More positively, members mentioned reduced risks, at least in the near term, related to US-China trade wars and Brexit.

Turning to the domestic economy, MPC members tended to expect that the upcoming release of national accounts data for the fourth quarter of 2018 will show growth close to zero, and that the first quarter of 2019 will also be weak. With the housing market stabilizing and the impact of oil production

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curtailments in Alberta fading after that, however, the group expected a rebound in activity that would gradually close any disinflationary output gap. Although recent data on the external balance and business investment show that the long-hoped-for rotation away from consumption is still elusive, the strong labour market and signs of wage gains – plus the possibility that a federal election will prompt new government spending – bolstered the group's optimism about domestic demand in late 2019 and 2020. On balance, these considerations supported the MPC's median call for a slightly higher overnight rate target in a year's time.

Votes of MPC Members and the Council Median for Each Announcement ( <i>percent</i> )				
MPC Members	March 6	April 24	Sept 2019	March 2020
<b>Steve Ambler</b> Université du Québec à Montréal (UQAM)	1.75	1.75	1.75	2.00
<b>Beata Caranci</b> TD Bank Group	1.75	1.75	1.75	2.25
<b>Edward A. Carmichael</b> Ted Carmichael Global Macro	1.75	1.75	1.75	1.75
<b>Michael Devereux</b> University of British Columbia	1.75	1.75	1.75	2.00
<b>Thorsten Koeppl</b> Queen's University	1.75	1.75	1.75	2.00
<b>Angelo Melino</b> University of Toronto	1.75	1.75	2.00	2.25
<b>Jean-François Perrault</b> Scotiabank	1.75	2.00	2.00	2.50
<b>Avery Shenfeld</b> CIBC	1.75	1.75	1.75	1.75
<b>Pierre Siklos</b> Wilfrid Laurier University	1.75	1.75	1.75	1.50
<b>Craig Wright</b> RBC	1.75	1.75	2.00	2.25
<b>Median Vote</b>	1.75	1.75	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 April 18, 2019 prior to the Bank of Canada's interest rate announcement on April 24, 2019.

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