C.D. Howe Institute Monetary Policy Council Urges Bank of Canada to Hold Overnight Rate at 1.00 Percent for Next Six Months; Looks for 1.25 Percent by November 2015

November 27, 2014 – The C.D. Howe Institute's Monetary Policy Council (MPC) today recommended that the Bank of Canada keep its target for the overnight rate, the very short-term interest rate it targets for monetary policy purposes, at 1.00 percent at its next announcement on December 3, 2014. Looking ahead, the Council called for the Bank to hold the target at 1.00 percent through the spring of 2015, and called for a target of 1.25 a year from now.

The MPC provides an independent assessment of the monetary stance appropriate for the Bank of Canada as it aims for its 2 percent inflation target. Finn Poschmann, the Institute's Vice President, Policy Analysis, chaired the Council's 91st meeting.

MPC 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, rounded up to the nearest quarter percentage point.

All eleven of the MPC members attending this meeting called for a 1.00 percent target at the upcoming announcement and at the subsequent announcement in January. Looking ahead to the May 2015 setting, nine members favoured a target of 1.00 percent, while two voted for 1.25 percent. The range for the November 2015 setting was three members wanting 1.00 percent, four members wanting 1.25 percent and four looking for 1.50 percent.

The launching point of the members' discussion was the wide range of recent relatively positive economic indicators in Canada and the United States, principal among them a firming of labour markets and of prices. Weighing heavily on the group's recommendations, however, was persistent weakness in commodities markets, especially with respect to the recent sharp decline in global oil prices.

Among the indicators that might militate for a less accommodative stance for monetary policy is the domestic consumer price index. The headline and core indices recently showed an unexpectedly sharp rise above the two percent target, contributing evidence that concerns over disinflation have abated.

Recent hourly wage growth and contract wage settlement data were seen as additional evidence that inflation expectations remain near two percent. Canada's labour market performance also showed strength generally, with unemployment rates sharply falling, and employment data showing private sector strength, and noticeably strong results for the 15-to-24 year old age bracket. Other positives included very strong credit market growth and strong business sector profits.

The positive data were offset, in Council members' view, by the potential impact of falling energy prices. While positive for significant sectors within Canada, the drop, if persistent, may be expected to have a significant negative impact in Western Canada. While the longterm overall impact of lower energy prices is perhaps uncertain, in the near to medium term the implication is a weakening in Canada's terms of trade, with a negative impact on gross national income, in part owing to the rise in energy's contribution to Canada's exports over the past decade.

Beyond volatility in oil prices and the domestic impact thereof, members discussed the extent to which the recent uptick in inflation might be generated by temporary factors. Those in favour of the temporary view, which was most MPC members, cited low price levels and inflation rates of a year ago, in some sectors, which could imply that the recently high rate is economically insignificant; some members also expressed doubts generally about the interpretation of year-over-year monthly measures versus longer-term measures of price and wage trends.

On balance, then, members felt that the uptick did not militate for an immediate change in recommendations for the timing and pace of eventual rises in the Bank of Canada's overnight rate. Some cautioned, however, that what is seen as a temporary shift upward may quickly be revealed as a more durable increase in inflation.

Among other reasons for caution was the global growth and inflation outlook, with the former looking positive but weak, and the latter decidedly weak, particularly in the euro zone. Factors cited included the potential for further, significant asset purchases by the European Central Bank and the Bank of Japan, which are maintaining downward pressure on bond yields.

The fact that global commodity prices other than oil have also trended downward also coloured members' views negatively, and led the group to the view that a prudent Bank of Canada stance would see overnight interest rates remain at their current level at least through summer 2015, by which time monetary policy would be expected to have tightened in the US.
The following table shows the votes of each MPC member, as well as the Council's median vote, for the relevant Bank of Canada policy-rate announcements.

MPC Members	Dec. 3	Jan. 21	6 months	12 months
Craig Alexander TD Bank Group	1.00%	1.00%	1.00%	1.25%
Steve Ambler Université du Québec à Montréal (UQAM)	1.00%	1.00%	1.25%	1.50%
Paul Beaudry University of British Columbia	1.00%	1.00%	1.00%	1.00%
Edward A. Carmichael Ted Carmichael Global Macro	1.00%	1.00%	1.00%	1.00%
Thorsten Koeppl Queens University	1.00%	1.00%	1.00%	1.50%
Stéfane Marion National Bank	1.00%	1.00%	1.00%	1.25%
Angelo Melino University of Toronto	1.00%	1.00%	1.00%	1.50%
Doug Porter BMO Capital Markets	1.00%	1.00%	1.00%	1.25%
Nicholas Rowe Carleton University	1.00%	1.00%	1.25%	1.25%
Avery Shenfeld CIBC World Markets Inc.	1.00%	1.00%	1.00%	1.50%
Pierre Siklos Wilfrid Laurier University	1.00%	1.00%	1.00%	1.00%
Median Vote	1.00%	1.00%	1.00%	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 January 15, 2015 prior to the Bank of Canada's interest rate announcement on January 21, 2014.

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Contact: Kristine Gray – phone: 416-865-1904; e-mail: kgray@cdhowe.org.