

January 7, 2019

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

January 7, 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 January 9, 2019, and to maintain that rate at the following announcement on March 6, 2019. The MPC further called for the target to rise to 2.00 percent by July of 2019, and to 2.25 percent by January of 2020.

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 eight members of the Council attending this meeting supported keeping the overnight rate at 1.75 percent this week and at the next announcement in March. By July, seven of the eight called for an increase to 2.00 percent, with the remaining member favouring keeping it at 1.75 percent. Looking ahead to January 2020, the recommendations ranged from 1.75 percent (one member), through 2.00 percent (one member), 2.25 percent (five members) and 2.75 percent (one member – see table).

The tendency for MPC members to want a higher overnight rate over time reflects a baseline expectation that the Canadian economy is operating close to its productive capacity, that activity and productive capacity will grow at roughly the same rate through 2019 and 2020, and that inflation will converge on the Bank's 2 percent target. Under those circumstances, the overnight rate should be higher than it currently is.

Their reluctance to recommend any increase until mid-year reflects many concerns about the world economy, negative sentiment, and a marked downshift in inflation expectations, including in Canada.



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On the global front, the discussion at this meeting highlighted slowing growth, notably in China, sharply lower commodity prices, and unnerving volatility in share prices. With respect to global politics, the discussion highlighted the potential damage from US-China trade disputes, Brexit, and the potential that US political dynamics might prevent the approval of the USMCA or even terminate the NAFTA. The US government shutdown was also a concern, partly because it suspends the collection and publication of key economic indicators, but mainly because it is a drag on US economic performance.

On the domestic front, these concerns inclined MPC members to worry about a further weakening in already lackluster business investment, and flagging consumer spending in cyclical areas such as automobiles and housing. For many members, lower inflation expectations – evident, for example, in a collapse of the spread between nominal and real-return bond yields – was a decisive reason to delay an increase in the overnight rate.

Looking further ahead, a number of participants noted that the deterioration in sentiment affecting financial markets could easily reverse – if, for example, US-China trade frictions abate. Many emphasized that financial and other sentiment indicators have been much more volatile than measures of real activity. Several noted in addition that Canadian households should be able to handle modest increases in borrowing costs. So the overnight rate should be higher in a year's time, but the approach to that level should be slow.



January 7, 2019

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

MPC Members	Jan 9	Mar 6	July 2019	Jan 2020
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	1.75
Thorsten Koeppl Queen's University	1.75	1.75	2.00	2.00
Stéfane Marion University of Toronto	1.75	1.75	2.00	2.25
Jean-François Perrault Scotiabank	1.75	1.75	2.00	2.75
Doug Porter BMO Capital Markets	1.75	1.75	2.00	2.25
Craig Wright RBC	1.75	1.75	2.00	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 February 28th, 2019 prior to the Bank of Canada's interest rate announcement on March 6th, 2019.

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