

Intelligence MEMOS



From: The C.D. Howe Institute Monetary Policy Council
To: Stephen Poloz, Governor of the Bank of Canada
Date: January 15, 2018
Re: **BANK OF CANADA SHOULD RAISE OVERNIGHT RATE TO 1.25 PERCENT THIS WEEK AND 1.75 PERCENT BY JANUARY 2018**

At our meeting last week we called for the Bank of Canada to raise its target for the overnight rate, the very short-term interest rate it targets for monetary policy purposes, to 1.25 percent at its next announcement on Wednesday. While we called for the target to stay at 1.25 at your March announcement, we recommend a target of 1.50 percent by July, and 1.75 percent in a year's time.

The Monetary Policy Council provides an independent assessment of the monetary stance consistent with the Bank of Canada's 2 percent inflation target. [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. (When the median vote falls in the middle of a 25-basis-point range, the mean "breaks the tie". On this occasion, the mean tipped the recommendation for January 2019 downward to 1.75 percent.)

Eight of the 10 MPC members attending this meeting called for a target of 1.25 percent this week, with two calling for a target of 1.00. By March, two of the eight wanting an immediate hike called for a further increase to 1.50. All members called for a higher target by July, and in one year's time, eight of the 10 called for a target of 1.75 or 2.00 percent.

The Council's tendency to favour increases in the overnight rate over the coming year was primarily a product of the strong Canadian labour market, and a judgement that inflation is likely to come in on target. Members who urged relatively quick adjustment of the overnight rate target to a level consistent with a growing economy and 2-percent inflation argued that strong domestic demand and income growth created both an opportunity and an obligation to bring the current period of extraordinarily low short-term interest rates and resulting speculative excesses to an end. Members who urged a slower pace pointed out that inflation has been slower than expected to rise, and several emphasized that a period of inflation slightly above target would do no harm to the economy or the Bank of Canada's credibility.

This meeting of the MPC was remarkable for relatively little discussion of risks overseas, reflecting the generally positive global economic environment. Much more salient were risks related to developments south of the border. The possibility that a termination of NAFTA would hurt exports and business investment weighed heavily on the discussion. Some members pointed out that if Canada reacted to US protectionism with its own – raising tariffs, for example – Canadian productive capacity would suffer and inflation would be at least temporarily higher. Others emphasized that US tax reform has further increased the relative attractiveness of investment south of the border. Several underlined that a lower Canada-US exchange rate is part of the adjustment we should expect to these developments – an adjustment that should be allowed to proceed.

The MPC's next vote will take place on March 1, prior to the Bank of Canada's interest rate announcement on March 7.

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