Stephen S Poloz: Opening statement before the House of Commons Standing Committee on Finance

Opening statement by Mr Stephen S Poloz, Governor of the Bank of Canada, before the House of Commons Standing Committee on Finance, Ottawa, Ontario, 6 June 2013.

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Introduction

The Bank of Canada's commitment to Canadians is to promote the economic and financial welfare of our country. One way we do this is to communicate our objectives openly and effectively and stand accountable for our actions.

So I thank you for the opportunity to come before you this morning to share the Bank's perspective. Kindly note that today is day four on the job for me – I trust you will forgive me if there are any details I haven't yet become familiar with. That said, I look forward to hearing your views and taking your questions, and I will answer them to the best of my ability.

The common denominator that ties together all of the Bank's work is confidence. Through our actions and our words, what the Bank of Canada delivers is confidence in our currency; confidence in our role as fiscal agent for the federal government; confidence in our banking system; and confidence in the value of money.

This is familiar ground to all of us here today. I don't propose to delve into the details of the Bank's functions. Rather, I will discuss the current context in which we are operating and how that is influencing the Bank's work of delivering confidence. In short: what are the challenges that we are facing? And, how do they affect the business of the Bank?

Today's global context

It is now almost six years since the start of the global financial crisis. Given the near-collapse of the global financial system and the dramatic plunge in global demand, it's perhaps no surprise that we haven't yet returned to normal economic conditions.

The global economy continues to struggle. Most advanced economies are still facing credit stresses and record-low interest rates. Many central banks continue to use unconventional means to provide stimulus, and governments are doing everything they can to manage their respective debt situations.

Clearly, the global economy is still in recovery. Global economic activity is expected to grow modestly this year before strengthening over the following two years. But this is not a recovery in the usual sense. It's more like a postwar reconstruction. It will require sustained and focused efforts to rebuild global economic potential.

Allow me to talk about how, in this context, the Bank of Canada delivers confidence.

Delivering confidence

Delivering confidence in our currency

Let me start with confidence in our currency which, for many Canadians, is our most tangible work. Every bank note in the wallets of Canadians is the product of specialized and sophisticated expertise. We have nearly 200 people – physicists, chemists, engineers and other experts – who design, test and distribute bank notes across Canada. We also communicate with retailers, financial institutions and the public, and work with law enforcement to deter counterfeiting.

The stakes are high when it comes to counterfeiting, not only in direct losses to Canadians, but also the loss of confidence that it creates in the use of bank notes.

The challenge of counterfeiting is significant. There was a time, in 2004, when counterfeiting in Canada was at a historic peak – and high by international standards. I'm sure many of you remember seeing signs posted in stores saying that $100 or $50 bank notes were not accepted.

The Bank of Canada introduced enhanced security features and worked closely with law-enforcement agencies, the RCMP, and the courts, as well as financial institutions and retailers, to bring those counterfeiting rates down. And we succeeded. Even before the introduction of our new polymer bank notes, counterfeiting rates had been reduced by 90 per cent.

But it's important to remember that staying ahead of counterfeiters is a constant challenge. We must always be proactive.

That is why the Bank launched a new series of polymer bank notes that are safer, cheaper, and greener. Safer, because of sophisticated security features, including holography and transparency, that make these new notes harder to counterfeit and easier to verify. Cheaper, because they last at least 2.5 times longer than paper-based notes. This means that fewer notes will need to be printed, making the series more economical.

And greener, because over the life of the series, fewer notes produced means fewer notes transported. And when they do need to be replaced, the notes will be recycled in Canada.

With these new notes, Canadians can have full confidence in their currency.

Delivering confidence in our funds management

The second area of our focus is much less visible to most Canadians. As the fiscal agent of the federal government, the Bank of Canada provides advice and administers the government's debt and reserves – and demonstrates global leadership in these realms. Innovative work is being done, for example, to reduce the reliance on external credit-rating agencies in the management of the government's assets and liabilities.

There is a lot of money at stake. In 2012, the Bank managed Government of Canada daily cash balances averaging about $17 billion. We also managed, on behalf of the government, official international reserves amounting to about US$69 billion.

Delivering confidence in our financial system

As with any plumbing system, we tend to take notice only when things go wrong. Through the crisis and since, the Bank's work has meant that the resilience of Canada's payment clearing and settlement system has been maintained at a very high level, ensuring that Canadians can have confidence that the economy is supported by solid financial market infrastructures.

Financial stability at home is necessary, of course, but not sufficient. The crisis made it abundantly clear that the global financial system needed remodelling – and the Bank of Canada has been at the forefront of global reform work.

Canada has also made good on our G-20 commitments. Among other reforms, we have put in place Basel III capital standards ahead of schedule. We have made significant strides on other market infrastructure reforms, which we can address in detail during our discussion.

These are real accomplishments, and our financial system is stronger as a result. But we must not lose momentum, here in Canada or on the international stage. More work is required to end the phenomenon of institutions that are too big to fail, including recovery and resolution plans for banks. And countries need to address the issue of shadow banking to ensure that systemically important financial institutions operating outside the perimeter of regulation come broadly into line with their regulated counterparts.

Delivering confidence in monetary policy

Finally, confidence is clearly important for the conduct of monetary policy.

Monetary policy in Canada is supported by a governance structure that instills confidence and ensures that Canadians, through their government, have a say in setting the monetary policy framework. Importantly, the structure also ensures the independence of the central bank to make the right policy decisions to achieve our inflation target.

Canada's monetary policy framework is a good one. After a tremendous amount of research, Canada adopted an inflation-targeting regime in 1991. Since 1995, the target has been 2 per cent. We recognized early on that a commitment to hold inflation absolutely steady at 2 per cent was unrealistic. Shocks to the economy must be taken into account. So the framework is designed to keep total CPI inflation at the 2 per cent midpoint of a target range of 1 to 3 per cent over the medium term. It bears mentioning that the target is symmetrical. We care just as much about inflation falling below as we do about it rising above the target. The Bank raises or lowers its policy interest rate, as appropriate, in order to achieve the target typically within a horizon of six to eight quarters – the time that it usually takes for policy actions to work their way through the economy and have their full effect on inflation.

Over the past couple of decades, the average rate of inflation has been very close to target. Even during the global economic and financial crisis, our commitment did not waver. The inflation target is sacrosanct to us and has become a credible anchor for the inflation expectations of Canadians.

A key component of the Bank of Canada's inflation-targeting framework is a flexible exchange rate. While the exchange rate is influenced by such variables as commodity prices, relative inflation rates, and relative interest rates, its value is determined in currency markets.

The credibility earned by the Bank over the past twenty years allows us to take advantage of the flexibility inherent in the framework with respect to the amount of time it takes to return inflation to target. The recent turmoil tested the limits of our flexible inflation-targeting framework. Nonetheless, the inflation expectations of Canadians remain well anchored, proving that our framework is secure and working. But it also informs us that we need to validate those expectations to maintain our credibility.

This brings me to a discussion of the domestic context.

The context in Canada

The severity of the global economic and financial crisis meant that the recession it triggered in Canada was different from any other postwar recession. Canada experienced a particularly deep contraction of investment and exports, as business confidence plummeted along with global demand.

In the immediate aftermath of the crisis, stimulative monetary and fiscal policies proved highly effective in supporting robust growth in domestic demand, particularly household expenditures, which grew to record levels. Yet, as effective as it has been, with domestic demand now slowing, the limits of this growth model are clear.

What's less clear is the rebuilding process underlying the necessary rotation of growth toward net exports and business investment. While the Canadian economy as a whole has recovered from the recession, thanks to domestic demand, the depth and duration of the global recession delivered a direct, sharp blow to Canadian business. In many cases, temporary plant shutdowns were not sufficient to match the fall in demand. Some firms permanently downsized their operations. Others simply closed their doors. Large job losses resulted.

In effect, the recession caused a significant structural change in the Canadian economy. The level of our country's productive capacity – in other words, its potential – dropped, as the Bank noted in April 2009. Standard macroeconomic models don't really capture these dynamics.

Just as the financial crisis triggered an atypical recession, the recovery cycle is unusual. The rotation of demand will require more than just the ramping up of production. The sequence we can anticipate is the following: foreign demand will recover; our exports will strengthen further; confidence will improve; companies will invest to increase capacity; existing companies will expand and new ones will be created.

In short, we need to see the reconstruction of Canada's economic potential, and a return to self-sustaining, self-generating growth.

This sequence may already be underway.

We are now seeing signs of recovery in some important external markets, notably the United States and Japan, and there is continued growth in emerging-market economies. The Bank expects that the gathering momentum in foreign demand should help lift the confidence of Canada's exporters. This is critical for Canadian firms to boost their investment to expand their productive capacity.

Conclusion – confidence in words, as well as actions

The Bank has a role to play nurturing that process, to the extent possible within the confines of our inflation-targeting framework. There is no conflict between nurturing this and our need to get inflation up to the 2 per cent target.

In monetary policy, actions are critically important, but words, too, matter a great deal. We can bolster confidence by explaining the forces at work in our economy, our projections for what's ahead, and our monetary policy response. And we help nurture confidence by listening to businesses, to labour groups, and to industry associations in order to expand our understanding of what's happening in the real economy.

We must always remember that beneath our economic and financial statistics and analysis are real people, making real decisions that can lead to bad outcomes as well as good ones. Those decisions are hard to make any time, but when uncertainty is high and confidence has not been fully restored, they can be even more difficult. A lack of confidence can mean that such decisions are postponed – and that opportunities are lost.

To help engender confidence, an active engagement with Canadians must be a cornerstone of the policy of the Bank of Canada, not least of which is a continuing dialogue with this committee.

With that, I thank you for listening. I would be pleased to take your questions.