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, 24 October 2016.

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Good afternoon, Mr. Chairman and committee members. Senior Deputy Governor Wilkins and I are happy to be before you today.

It is our normal practice to appear before this committee twice a year to discuss the Bank's *Monetary Policy Report* (MPR). We published our latest MPR last week and are happy to answer questions about it and other economic topics. However, I suspect you may also want to ask about the agreement with the federal government that was announced this morning, which renews our inflation-control framework for another five years. So, before we respond to questions, allow me to say just a few words on both topics, beginning with the MPR.

Since our last appearance, there have been two developments that led us to downgrade our outlook for the Canadian economy. The first is a lower trajectory for exports. After a sharp decline in goods exports over five months, we had a rebound in July and August. But that was not enough to make up for the ground that had been lost. We worked hard to determine the reasons for this shortfall. About half of it can be explained by weak global trade and composition changes in US demand, but the rest is unclear. So, in our outlook, we now assume that longer-term structural issues, such as lost export capacity and competitiveness challenges, are responsible for the remainder. This assumption led us to reduce the projected level of GDP by the end of 2018 by about 0.6 per cent, compared with our July projection.

The second major factor behind our downgraded growth outlook is the federal government's macroprudential measures to promote housing market stability. These measures are welcome because they will, over time, ease vulnerabilities related to housing and household imbalances. That is important because such vulnerabilities can magnify the impact of negative economic shocks.

We expect the government's measures will restrain residential investment by curbing resale activity in the near term and lead to a modest change in the composition of construction toward smaller units. We estimate that this will leave the level of GDP 0.3 per cent lower at the end of 2018 than projected in July.

Given these developments, we cut our growth estimate for 2016 to 1.1 per cent. The expansion in both 2017 and 2018 should be about 2.0 per cent, which is above the growth rate of potential. However, because the output gap is now somewhat larger and will close later than we projected in July, the profile for inflation is now slightly lower. We project that total CPI inflation will remain below 2 per cent through the end of the year and be close to the 2 per cent target in 2017 and 2018.

The outlook is clouded by a number of uncertainties. These include the macroeconomic effects of the new mortgage rules, the likely path of our exports, the impacts of the federal government's fiscal measures and the effects of the US election on business confidence. Given the two-sided nature of these uncertainties, and with the flexibility inherent in our inflation-targeting framework, we judged that the current setting for monetary policy remains appropriate.

Let me now talk about the renewal of the inflation-targeting framework. Today, the Bank and the government announced that we will continue to target inflation at the 2 per cent midpoint of a 1 to 3 per cent range for another five years. This is good news, as our framework has served

Canadians well, in both calm and turbulent times, for 25 years.

The framework's track record is impressive. Annual inflation has averaged almost exactly 2 per cent since 1991. Inflation has also been more stable, which has meant that unemployment and interest rates have become lower and more stable. In turn, this has helped households and firms make spending and investment decisions with more confidence, encouraged investment, contributed to sustained growth in output and productivity, and improved Canada's standard of living.

As is the case at every renewal, a great deal of research and analysis went into the process, and we took on board the experiences and lessons of the past five years. Bank staff published dozens of research papers and worked with researchers from other central banks and academic institutions as well as private-sector economists. And, as usual, we asked some fundamental questions to make sure inflation targeting is still delivering its economic benefits effectively. We examined potential alternatives to inflation targeting to see if they provide even more benefits. That is one of the great advantages of our five-year renewal cycle—the framework is not set in stone; we are always looking for ways to improve it.

Now, it is fair to say that even after years of very low interest rates, the recovery from the Great Recession in many economies remains weak. So it is not really surprising that some are wondering if monetary policy has lost its power. Low interest rates are actually doing a great deal to support the economy. To illustrate this point, if we were to raise interest rates to pre-crisis levels, say 3 to 4 per cent, there would be a significant contraction in the economy, and it is these contractionary forces that we are offsetting with low interest rates.

But while monetary policy is still powerful, it is true that at the current setting, the impact of any interest rate reduction is less than it would be if rates were at historically normal levels. That is the case in a number of economies. In this environment, it is particularly important that all policies—monetary, fiscal and macroprudential—be working in a complementary way.

This is why our agreement with the government is crucial. The government is making it clear that it also supports low, stable and predictable inflation, while leaving us the independence to pursue that goal as we see fit. It is a framework that has worked extraordinarily well for 25 years and, after looking at all the evidence, we could find no compelling reason to change it.

With that, Mr. Chairman, Carolyn and I would be happy to answer questions.