Mark Carney: Opening statement for appearance before the House of Commons Standing Committee on Finance

Opening statement by Mr Mark Carney, Governor of the Bank of Canada, presented to the House of Commons Standing Committee on Finance, Ottawa, Ontario, 19 August 2011.

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Thank you for this opportunity to appear here today.

Recent economic and financial developments

In recent weeks, several downside risks to the Bank's July *Monetary Policy Report* (MPR) projection have been realised. The European sovereign crisis has intensified, the U.S. credit rating has been downgraded, and a broad range of data has signalled slower global growth.

The United States is in the midst of the weakest recovery since the Great Depression. This is not a surprise as history teaches that recessions involving financial crises tend to be more severe and have recoveries that take twice as long. Recent benchmark revisions show that the U.S. recession was even deeper and the recovery from the trough has been even shallower than previously reported.

The Bank expects that American household spending will remain subdued in the face of high personal debt burdens, large declines in wealth and tough labour market conditions. In addition, fiscal stimulus in the United States will soon turn to fiscal drag.

For well over a year, the Bank has been concerned about the prospects for resolving internal tensions within the Euro area. Some of these concerns are now being realised as acute fiscal and financial strains in Europe have triggered a generalized retrenchment from risk-taking and could yet prompt more severe dislocations in global funding markets.

In response to uncertainties in Europe and the evidence of slowing global growth, equity and commodity prices have fallen significantly, and financial market volatility has increased markedly. The spillovers to Canadian financial markets have been less pronounced but are still notable. Importantly, Canadian financial stocks have considerably outperformed their peers in the United States, the United Kingdom and Europe and our core funding markets have remained orderly. This will help ensure an appropriate flow of credit to Canadian households and businesses.

Recent events serve as a reminder that in a world awash with debt, repairing the balance sheets of banks, households and countries will take years. As a consequence, the pace, pattern and variability of global economic growth is changing, and Canada must adapt.

In short, the considerable external headwinds that the Bank has long identified are now blowing harder. For Canadian producers, the persistent strength of the Canadian dollar is compounding the sluggishness of U.S. demand. Largely reflecting such external factors, recent Canadian data has been consistent with minimal to slightly negative growth in the second quarter. At the same time, labour market developments and business investment intentions suggest continued strength in our domestic economy.

The Bank continues to expect that growth will accelerate in the second half of the year, led by business investment and household expenditures. Ongoing strength in major emerging markets should also help maintain commodity prices at relatively high levels. However, relative to our prior expectations, we expect somewhat weaker economic momentum globally and, as a result, in Canada, with attendant consequences for resource utilization and inflationary pressures.

Policy considerations

Since the crisis began, the broad economic strategy has been to grow domestic demand in the face of these considerable external headwinds and to encourage Canadian businesses to retool and reorient to the new global economy.

In response to the sharp, synchronous global recession, the Bank lowered our target rate rapidly to its lowest possible level. We almost doubled our balance sheet to provide the financial sector with exceptional liquidity. And we gave exceptional guidance on the likely path of our target rate, through our conditional commitment.

In tandem, federal and provincial fiscal stimulus provided important further support to domestic demand, contributing significantly to Canadian economic growth through 2009 and 2010.

Owing to the underlying strength of domestic fundamentals, particularly our resilient financial system, these policies proved highly effective. Domestic demand in Canada grew more than twice as fast as in the United States. Canada has recovered all of the output and about 140 per cent of the jobs lost during the recession. Throughout, price stability has been maintained.

As the Minister of Finance has rightly emphasised and recent events have reinforced, fiscal sustainability is fundamental. It is essential to maintain Canada's fiscal advantage with an appropriately paced fiscal consolidation plan, consistent with the G-20's Toronto Summit commitments.

Similarly, private credit cannot grow without limit. Canadians are now as indebted as the Americans and the British.

In an environment of exceptionally low interest rates, we must be careful not to repeat the mistakes of others who now face the challenges of simultaneously lowering unsustainable public and private debt burdens.

Bank policy

There are five ways in which the Bank will continue to support Canada's economic expansion in this difficult external environment.

First, the best contribution that monetary policy can make is to keep inflation low, stable and predictable. Monetary policy is guided by our 2 per cent target for total CPI inflation. This is a symmetric commitment. That is, the Bank cares as much about inflation being below target as above.

Since the crisis erupted, the Bank has demonstrated its flexibility and nimbleness in the conduct of monetary policy. As the Canadian recovery has progressed, we have emphasised that we would be prudent with respect to the possible withdrawal of any degree of monetary stimulus.

As we highlighted in our most recent MPR, our approach will always be guided by comprehensive, considered analysis and informed judgment rather than mechanical rules. This is particularly important in the current environment of material external headwinds. To state the obvious, if the outlook for growth and inflation changes, the path for monetary policy will be affected accordingly.

Second, the Bank will take the necessary steps to ensure that core funding markets remain liquid. In the event of a major systemic shock, the Bank has a wide range of tools to provide exceptional liquidity, consistent with a principles-based framework. At the same time, central bank liquidity should not be a substitute for sound risk management by private financial institutions. Accordingly, the Bank will continue to work with the Office of the Superintendent of Financial Institutions (OSFI) to guard against moral hazard by ensuring that private banks maintain adequate liquidity buffers.

Third, we must continue to build a more resilient financial system in Canada and globally. Recent events underscore the importance of implementing G-20 financial reforms, notably the capital and liquidity requirements under Basel III. Given the leading positions of our banks and the consistency of the new standards with Canada's, now is not the time for Canada to move from the front to the back of the class. Moreover, it is in Canada's interests to ensure that others follow our example. This will reduce the risk that another foreign financial crisis sideswipes our economy.

Fourth, the Bank will continue to work with its federal partners to monitor risks to financial stability and to develop appropriate responses. An example has been the measured approach to rising household indebtedness. Since 2008, the federal government has taken a series of prudent and timely measures to tighten mortgage insurance requirements in order to support the long-term stability of the Canadian housing market.

Finally, since the biggest risks to our economy come from abroad, the Bank must work with international colleagues as they tackle the twin challenges of reducing excessive private and public debt. The situation is most acute in Europe where credible national fiscal plans need to be supplemented by broader changes to European economic governance and fiscal arrangements. We are in constant, intensive discussions with our European colleagues bilaterally and through the G-7, the G-20, the Bank for International Settlements and the Financial Stability Board.

As the Bank has stressed repeatedly, the core challenge is to rebalance demand between advanced and emerging economies. To this end, the Bank is investing in current G-20 efforts to develop a framework for open capital flows, working with the FSB to devise and implement comprehensive financial reforms, and collaborating with our colleagues in the Department of Finance to guide the G-20 framework for strong, sustainable and balanced growth. Rebalancing will require significant changes to fiscal, structural and exchange rate policies across a broad range of countries.

To conclude, the challenges in the current global economic environment are significant, but so too are the opportunities for Canada. Our corporations and governments have strong balance sheets, our financial institutions are among the most resilient in the world, and our economy can be geared to the future sources of global growth. To take advantage of these attributes, we will need continued, heavy investment to improve productivity and sustained, innovative efforts to develop new markets.

For its part, the Bank has a wide range of tools and policy options that it will continue to deploy as appropriate in order to ensure that Canadians can seize these opportunities in an environment of domestic macroeconomic and financial stability.