Stephen S Poloz: Summary of the latest *Monetary Policy Report*

Opening statement by Mr Stephen S Poloz, Governor of the Bank of Canada, at the press conference following the release of the *Monetary Policy Report*, Ottawa, Ontario, 22 January 2014.

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Good morning. Tiff and I are pleased to be here with you today to discuss the January *Monetary Policy Report*, which the Bank published this morning. Before we take your questions, allow me to note the highlights of the Report.

- Inflation in Canada has moved further below the 2 per cent target. This is due largely to significant excess supply in the economy and heightened competition in the retail sector. The path for inflation is now expected to be lower than previously anticipated for most of the projection period.
- The Bank expects inflation to return to the 2 per cent target in two years or so, as the effects of retail competition dissipate and excess capacity is absorbed.
- The global economy is expected to strengthen over the next two years, rising from 2.9 per cent growth in 2013 to 3.4 per cent in 2014 and 3.7 per cent in 2015.
- The United States will lead the way, helped by diminishing fiscal drag, accommodative monetary policy and stronger household balance sheets. The improving U.S. outlook is affecting global bond, equity, and currency markets.
- Growth in other regions is evolving largely as projected in October.
- Global trade growth plunged after 2011, but is poised to recover as global demand strengthens.
- In Canada, economic growth improved in the second half of 2013. However, there have been few signs of the anticipated rebalancing towards exports and business investment.
- While we are doing more work to understand the wedge between the level of Canadian exports and that of foreign demand, this remains difficult to explain. We are therefore taking a conservative approach to our forecasts for exports, and assuming the wedge will remain.
- That said, the U.S. recovery is becoming more broad-based, including higher investment spending by companies, and that, as well as the recent depreciation of the Canadian dollar, should help to boost exports. This, in turn, should lead to stronger business confidence and investment here in Canada.
- Meanwhile, recent data have been consistent with the Bank's expectation of a soft landing in the housing market and a stabilization of household indebtedness relative to income.
- Real GDP growth is projected to pick up from 1.8 per cent in 2013 to 2.5 per cent in both 2014 and 2015. This implies that the economy will return gradually to capacity over the next two years or so.
- Our recent analysis has given us an improved, yet still incomplete, understanding of the inflation picture. We now believe the effect of heightened retail competition will subtract about 0.3 percentage points from core inflation in 2014. This effect will be more persistent than initially thought.
- This finding, though, does not explain all of the weakness in inflation. And so, we are exploring whether the output gap has a greater impact on inflation than previously

believed, especially when the gap is persistent. This interpretation seems to be relevant for other countries, as well as Canada.

- While increased competition will have a permanent effect on the level of prices, it will have a transitory effect on the rate of inflation. As such, we believe policy should look through it.
- Although the fundamental drivers of growth and future inflation appear to be strengthening, inflation is expected to remain well below target for some time, and therefore the downside risks to inflation have grown in importance. At the same time, risks associated with elevated household imbalances have not materially changed.
- Weighing these considerations, the Bank judges that the balance of risks remains within the zone articulated in October, and therefore has decided to maintain the target for the overnight rate at 1 per cent. The timing and direction of the next change to the policy rate will depend on how new information influences this balance of risks.

With that, Tiff and I would be pleased to take your questions.