Tiff Macklem: Renewal of the Monetary Policy Framework

Opening statement by Mr Tiff Macklem, Governor of the Bank of Canada, at the press conference on the renewal of the monetary policy framework, Ottawa, Ontario, 13 December 2021.

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The objective of Canada's monetary policy is to promote the economic and financial well-being of Canadians. Experience has shown that the best way monetary policy can achieve this goal is by maintaining a low and stable inflation environment. Doing so supports a strong and inclusive labour market that provides every Canadian with opportunities for a good quality of life.

Currently, the reopening of the global economy is associated with elevated inflation in Canada and abroad. While this is a global phenomenon, it makes maintaining a sound framework for monetary policy in Canada all the more important.

From a longer-term perspective, since the adoption of an inflation-targeting framework 30 years ago, consumer price index (CPI) inflation has averaged close to 2 percent, despite periods of both upward and downward pressures on inflation. The maintenance of low, stable and predictable inflation has also contributed to Canada’s strong labour market performance. In the current context, Canada’s inflation-targeting framework helps to ensure that inflation will return to 2 percent over the medium term.

The Government of Canada and the Bank of Canada believe that the best contribution of monetary policy to the well-being of Canadians is to continue to focus on price stability. The Government and the Bank also agree that monetary policy should continue to support maximum sustainable employment, recognizing that maximum sustainable employment is not directly measurable and is determined largely by non-monetary factors that can change through time. Further, the Government and the Bank agree that because well-anchored inflation expectations are critical to achieving both price stability and maximum sustainable employment, the primary objective of monetary policy is to maintain low, stable inflation over time.

This renewal of Canada’s monetary policy framework is occurring at a time when changes to the economy are complicating the task of monetary policy. The global financial crisis and COVID-19 pandemic have had a significant impact on the global economy and financial system, and major trends such as shifting demographics and new digital technologies are altering the economic landscape. Climate change and the long-term transition to net-zero greenhouse gas emissions will drive structural change in the Canadian and global economies. Also, there is now greater recognition, supported by economic research, that when the benefits of economic growth and opportunity are more evenly shared, it leads to more prosperity for the whole economy. A strong and inclusive labour market helps reduce income inequality and supports robust demand for goods and services.

Monetary policy is well equipped to address some of these challenges, less so for others. Two developments are particularly salient to the conduct of monetary policy:

- Neutral interest rates are likely to be lower than in the past, which means that central banks will have less room to lower their policy interest rates in the face of large adverse shocks to the economy.
- Major forces, including demographics, technological change, globalization, and shifts in the nature of work, are having profound effects on the Canadian labour market. These evolving forces have increased uncertainty about the level of maximum sustainable employment (i.e., the level of employment beyond which inflationary pressures arise).

Consequently, the Government of Canada and the Bank of Canada agree to renew the inflation target on the following basis:

- The target will continue to be defined in terms of the 12-month rate of change in the total CPI.
- The inflation target will continue to be the 2 percent mid-point of the 1 to 3 percent inflation-control range.
- The agreement will run for another five-year period, ending December 31, 2026.

The Government and the Bank further note that:

- Given that there is uncertainty about the maximum level of employment that is consistent with price stability, the Bank will continue to use the flexibility of the 1 to 3 percent control range to actively seek the maximum sustainable level of employment when conditions warrant.
- The Bank will consider a broad range of labour market indicators and will systematically report to Canadians on how labour market outcomes have factored into its monetary policy decisions.
- The Bank will also continue to leverage the flexibility of the 1 to 3 percent range to help address the challenges of structurally low interest rates by using a broad set of tools, including sometimes holding its policy interest rate at a low level for longer than usual.
- The Bank will utilize the flexibility of the 1 to 3 percent range only to an extent that is consistent with keeping medium-term inflation expectations well anchored at 2 percent.
- The Bank will explain when it is using the flexibility in the framework.

The Government and the Bank acknowledge that a low interest rate environment can be more prone to financial imbalances. In this context, the Government will continue to work with all relevant federal agencies to ensure that Canadian arrangements for financial regulation and supervision are fit-for-purpose and consider changes if and where appropriate.

Additionally, while monetary policy cannot directly tackle the threats posed by climate change, the Bank will develop the modelling tools needed to take into account the important implications of climate change on the Canadian economy and financial system.

Finally, recognizing the limits of monetary policy, the Government and the Bank also acknowledge their joint responsibility for achieving the inflation target and promoting maximum sustainable employment.