



BANK OF CANADA

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Bank releases background information on renewal of the inflation-control target

OTTAWA -- The Bank of Canada today released the document *Renewal of the Inflation-Control Target: Background Information*, which provides additional details on the target arrangements and on how the Bank plans to implement them in order to increase the predictability of inflation over the longer term. This release follows the announcement yesterday by the Government of Canada and the Bank that the inflation-control target is being renewed for a period of five years to the end of 2006.

The document points out that the basic framework for conducting monetary policy under the inflation-control target is being maintained, but that the Bank is strengthening the way the target arrangements are implemented. The following are the key elements of the approach to implementing the renewed target:

- **The inflation target:** To maximize the likelihood that inflation stays within the 1 to 3 per cent target range, monetary policy needs to aim at the 2 per cent target midpoint. Given the lags in the effect of monetary policy, policy actions will be directed to moving inflation to the target midpoint over a six-to-eight-quarter horizon. Predictability of average inflation over longer time horizons is desirable. Monetary policy can deliver this predictability by consistently aiming at 2 per cent for the 12-month rate of inflation.
- **Term of the agreement:** The Bank and the government have agreed on a five-year horizon for the target agreement. This longer period will give Canadians greater assurance that low inflation will be a continuing feature of the Canadian economic environment and will facilitate long-term planning.
- **Measurement of the target rate of inflation:** The inflation target will continue to be set in terms of the 12-month increase in the total consumer price index (CPI). The use of the CPI as the basis for the target reflects its role as the most commonly used indicator of inflation in the Canadian economy and the most relevant estimate of the cost of living for most Canadians.
- **Core inflation as an operational guide to policy:** While the overall target is defined in terms of the total CPI, the Bank finds it useful to use a core measure of inflation as a short-term operational guide to policy. After a thorough assessment, the Bank has decided to adopt a more refined measure of core inflation that better captures the underlying trend of inflation. This measure, which the Bank has published in the past as CPIX, excludes only the eight components with the most volatile prices. It also excludes the effect of changes in indirect taxes. Starting in June 2001, Statistics Canada will publish in its monthly releases the CPI excluding these components.

The Bank will publish both the effect of changes in indirect taxes on this measure and the resulting measure of core inflation.

- **Reporting on inflation outcomes:** If CPI inflation persistently deviates from the 2 per cent target midpoint, the Bank will give special attention in its *Monetary Policy Reports* or *Updates* to explaining why inflation has deviated to such an extent from the target midpoint, what steps (if any) are being taken to ensure that inflation moves back to this midpoint, and when inflation is expected to return to the midpoint.