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Opening statement by Mark Carney CHECK AGAINST DELIVERY
Governor of the Bank of Canada
to the House of Commons Standing Committee on Finance
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Good morning. Paul and I are pleased to appear before this committee to discuss the Bank of Canada's perspective on the current state of the domestic and global economies.

Let me state at the outset that the speed and synchronized nature of the recent global downturn has resulted in a heightened degree of uncertainty, which is evident in the diverse views on the outlook. Indeed, it is safe to say that the degree of uncertainty – the range of possible outcomes – is greater than the range of point forecasts. It is in this environment that considerable policy actions are being taken globally: the provision of liquidity to stabilize global financial markets, the write-down of assets and the re-capitalization of institutions, and macroeconomic policy measures to boost aggregate demand. A considered and coherent perspective on the likely success of these policies importantly shapes our view of the outlook for the global and Canadian economies.

Global Outlook – Sudden, Synchronized, and Deep Recession

The outlook for the global economy has deteriorated significantly in recent months. What began last autumn as a relatively controlled slowdown has become a sudden, synchronized, and deep global recession. The proximate cause was the intensification of the global financial crisis owing to both the failures of several prominent global financial institutions and the growing realization that this was a solvency crisis rather than a liquidity crisis. The recession that originated in the United States is now spreading globally through confidence, financial, and trade channels.

In the process, the inevitable correction of unsustainably large current account imbalances in several major economies is now under way. For example, we project that the U.S. current account deficit will narrow to 3 per cent of GDP in 2009, about half its size in 2006. The sustainable rebalancing of global domestic demand from deficit countries such as the United States and the United Kingdom towards surplus countries such as China and Germany will take some time and is likely to dampen the pace of global growth during that period.

In the Bank's January *Monetary Policy Report Update*, we projected that global economic growth will be tepid this year – just 1.1 per cent – before rebounding mildly to a below-trend rate of 3.7 per cent in 2010. As part of that projection, we expect that the eventual U.S. recovery will be much slower than usual. For example, we project that it will take two and half years from the onset of the recession for U.S. GDP to return to its pre-recession level. This sluggishness reflects the lingering effects of the crisis on the U.S. financial system and the slow recovery of domestic consumption owing to the magnitude of wealth effects and the deterioration in the labour market.

Reflecting the seriousness of the shock, the global macroeconomic policy response has been unprecedented. In the wake of the intensification of the crisis, monetary policy rates have been substantially and rapidly reduced in most major economies. Fiscal policy initiatives have also been robust, with the world well on its way to spending an average of more than 2 per cent of global GDP in discretionary fiscal measures. These measures will replace some of the lost private demand and – equally importantly – create a window for the necessary rebalancing of global growth. Simultaneous fiscal action is not only more powerful than measures taken in isolation, but also has the potential to provide some support for commodity prices. Given typical lags, the effects of these monetary and fiscal policies will be felt increasingly over the course of this year and 2010.

Canadian Outlook – Sharp Recession and Milder-Than-Usual Recovery

The global downturn and declining demand for our exports will make this a very difficult year for Canada's economy. We are now in recession with GDP projected to fall by 1.2 per cent this year. The first half of the year will be particularly challenging with sharp falls in activity and increases in unemployment. Unfortunately, last Friday's employment report is broadly consistent with our outlook. The 14 per cent drop in our terms of trade since July will translate into a significant reduction in Canadian incomes and thus in our ability to sustain real domestic spending in the economy. Losses by Canadians on their financial holdings, either directly or via their pension funds, and concerns about the employment outlook will also restrain domestic consumption this year. Uncertainty about the economic outlook and strained financial conditions should lead to declines in investment spending this year.

In our base-case projection, real GDP is expected to rebound in 2010, growing by 3.8 per cent. Though seemingly impressive when viewed from the depths of a recession, such a recovery is actually more muted than usual. The recovery should be supported by:

- the timeliness and scale of our monetary policy response;
- our relatively well-functioning financial system and the gradual improvements in financial conditions in Canada next year;
- the past depreciation of the Canadian dollar;
- stimulative fiscal policy measures;
- the rebound in external demand in 2010, particularly in emerging markets, and the associated firming of commodity prices;
- the strengths of Canadian household, business, and bank balance sheets; and
- the end of the stock adjustments in Canadian and U.S. residential housing.

A wider output gap and modest decreases in housing prices should cause core CPI inflation to ease through 2009, bottoming out at 1.1 per cent in the fourth quarter. Total CPI inflation is expected to dip below zero for two quarters in 2009, reflecting year-on-year drops in energy prices. The Bank views the possibility of deflation in Canada as remote.

Indeed, with inflation expectations well anchored, total and core inflation should return to the 2 per cent target in the first half of 2011 as the economy moves back to its production potential. Of course, global developments pose significant upside and downside risks to the inflation projection. The Bank judges that these risks are roughly balanced.

Uncertainty and the Need for Policy Action

As I noted at the outset, in the current environment the Bank’s projections – and those of all forecasters – are subject to an unusually high degree of uncertainty.

As we have consistently emphasized, stabilization of the global financial system is a precondition for economic recovery globally and in Canada. To that end, throughout the world, policy-makers have acted aggressively and creatively. Central banks have provided unprecedented liquidity to keep the financial system functioning. Last October, extraordinary steps were taken by all G-7 countries to prevent systemic collapse and to promote the effective functioning of money and credit markets.

The task is far from complete. Decisions taken in the coming weeks in the United States and in other major economies to isolate toxic assets in order to create a core of “good” banks will be critical. In addition, G-20 countries need to act in concert to improve domestic and international regulatory frameworks. In this regard, measures to improve transparency and integrity, to implement a macro-prudential approach to regulation, and to adequately resource the IMF are vital.

If these national and multilateral measures are not timely, bold, and well-executed, Canada’s economic recovery will be both attenuated and delayed. The reality is that the financial crisis and subsequent recession originated beyond our borders and the necessary triggers for a sustainable recovery must be found there as well. Canada has much to offer to these efforts, which is why the Bank is working closely and tirelessly with our international colleagues.

At home, the Bank has acted decisively. We have eased monetary policy by 350 basis points since December 2007, including 250 basis points since the start of October. In doing so, we cut rates deeper and sooner than most other major central banks. With the strains in our financial system considerably less than elsewhere, monetary conditions have eased significantly in Canada since the start of the crisis. In fact, we are entering this recession with negative real interest rates – an unprecedented situation. In time, this will have a powerful impact on economic activity and inflation.

Guided by Canada's inflation-targeting framework, we will continue to monitor carefully economic and financial developments in judging to what extent further monetary stimulus will be required to achieve the 2 per cent target over the medium term. The Bank retains considerable policy flexibility, which we will use if required.

In challenging times such as these, people, rightly, look to a few constants: to institutions that they can rely upon and to certain expectations that will be met. Canadians can rely on the Bank of Canada to fulfill its mandate; they can expect inflation to be low, stable, and predictable. The relentless focus of monetary policy on inflation control is essential in this time of financial crisis and global recession and remains the best contribution that monetary policy can make to the economic and financial welfare of Canada.