Opening Statement by Mark Carney
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Standing Senate Committee on
Banking, Trade and Commerce
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Opening Statement for Appearance Before the Standing Senate Committee on Banking, Trade and Commerce

Good afternoon, Mr. Chairman and committee members. Tiff and I are pleased to appear today to discuss the Bank of Canada's analyses of the economic outlook and the stability of the financial system. We look forward to your questions and the discussion that follows.

The Bank's most recent comprehensive assessment of the economy was presented in its April *Monetary Policy Report* (MPR). On 31 May, the Bank issued its latest policy rate announcement. These provide the basis for my comments today. Please bear in mind that the Bank's next full economic analysis will be published in the upcoming MPR, which will be released on 20 July 2011.

I will also take a few moments this afternoon to outline the highlights of the Bank's *Financial System Review* (FSR), which was released just this morning. The FSR reviews developments in the financial system and identifies potential vulnerabilities.

Beginning with the economic outlook:

- The global recovery is proceeding broadly as we had expected in April.
- The U.S. economy continues to grow at a modest pace, limited by the consolidation of household balance sheets.
- Growth in Europe is maintaining momentum, although the risks related to peripheral economies have clearly increased. The disasters that struck Japan in March are severely affecting its economic activity and are also causing temporary supply chain disruptions in advanced economies, including Canada.
- Although commodity prices have declined recently, they are expected to remain at elevated levels, supported by tight global supply and very strong demand from emerging markets.
- These high prices, combined with persistent excess demand conditions in major emerging-market economies, are contributing to broader global inflationary pressures.

- Despite the challenges that weigh on the global outlook, financial conditions remain very stimulative.
- In the short term, economic growth in Canada is expected to slow to modest rates, due to a number of temporary factors. These include the supply chain disruptions that will dampen automotive production, as well as the drag from adjusting to higher energy prices on consumer spending in Canada and the United States.
- Overall, a broad rebalancing of demand in Canada is underway as the economic expansion progresses. Business investment is now growing strongly, and contributions to growth from both household consumption and government spending are diminishing. As I will discuss in a moment, in this context, the Bank anticipates a slowing in both the rate of household credit growth and the upward trajectory of household debt-to-income ratios.
- The recovery in net exports is expected to be modest given the relative weakness in the U.S. economy, Canada's underrepresentation in fast-growing emerging markets, and our competitiveness challenges, most notably due to the persistent strength of the Canadian dollar.
- While underlying inflation is relatively subdued, the Bank expects that high energy prices and changes in provincial indirect taxes will keep total CPI inflation above 3 per cent in the short term.
- Total CPI inflation is expected to converge with core inflation at 2 per cent by the middle of 2012, as excess supply in the economy is gradually absorbed, labour compensation growth stays modest, productivity recovers and inflation expectations remain well-anchored.
- The Bank expects a re-acceleration of growth in the second half of the year, consistent with a renewed narrowing of the output gap. We will update the projection in the July MPR.

Allow me to turn now to the Bank's monitoring of developments in the financial system.

- Although the Canadian financial system is currently on a sound footing, the Bank judges that, largely because of external factors, risks to its stability remain elevated and have edged higher since December. Of the five risks identified in the FSR, I would like to concentrate on three:
    - First, sovereign balance sheets remain strained in many advanced economies. Fiscal strains in the euro-area periphery have continued to build despite continued efforts by the affected countries and assistance from the International Monetary Fund and the European Commission. Whether or not a sovereign credit event occurs, these strains could trigger a sharp repricing of credit risk for other governments with high debt burdens, as well as a more generalized retrenchment from risk-taking in global markets, including markets in Canada.
    - Second, a long period of low interest rates globally may fuel excessive risk-taking. The search for yield could cause risk to be underpriced or lead investors to take on exposures that they may not be able to manage if conditions become less

benign. Our institutions should not be lulled into a false sense of security by current low rates.

- Lastly, the high level of household indebtedness has increased financial vulnerabilities in Canada. Canadians are now as indebted (relative to their income) as the Americans and the British. The Bank estimates that the proportion of Canadian households that would be highly vulnerable to an adverse economic shock has risen to its highest level in nine years, despite improving economic conditions and the ongoing low level of interest rates. This partly reflects the fact that the increase in aggregate household debt over the past decade has been driven by households with the highest debt levels.
- There are some offsets. Debt is largely fixed rate and household net worth is at an all-time high. However, borrowers should remember that a fixed-rate mortgage will reprice a number of times over the life of the mortgage and, while asset prices can rise and fall, debt endures.

- The elevated levels of household debt require continued vigilance. Since 2008, the federal government has taken a series of prudent and timely measures to tighten mortgage insurance requirements. These will reduce the possibility that prices are further driven up simply through higher leverage and, more broadly, support the long-term stability of the Canadian housing market.
- While these measures will help moderate the pace of debt accumulation by households, it will take some time for their full effect to be felt. Canadian authorities will continue to co-operate closely in monitoring the financial situation of the household sector.
- Despite the challenging international environment and increasing strains on household balance sheets, the Canadian financial system remains healthy. For example, asset quality at Canada’s major banks has improved further in recent months. Moreover, the aggregate financial position of the domestic non-financial corporate sector is solid, with corporate leverage remaining at low levels.
- Finally, I would like to note that on Monday, the Bank, along with the Minister of Finance and the Commissioner of the RCMP, unveiled a new generation of bank notes.
- These new notes are at the frontier of bank note technology. They are secure, durable and green. They will set a benchmark worldwide and will help maintain the confidence Canadians already have in their currency.

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