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CONTACT: Jeremy Harrison
613 782-8782

Canada's Inflation-Targeting Regime Enhances Economic Well-Being of Canadians, Says Bank of Canada Governor Mark Carney

MONTREAL, Quebec – The effectiveness of Canada's inflation-targeting regime, adopted in 1991, is well established, and partly responsible for the strength and relative stability of the Canadian economy, Governor Mark Carney of the Bank of Canada said today. "Over the past twenty years, Canadians have enjoyed a more stable and prosperous economic environment. Even during the recent crisis, the Canadian economy proved more resilient and recovered faster than our advanced-economy peers."

In a speech to the Board of Trade of Metropolitan Montreal, the Governor discussed three issues related to the inflation-targeting framework, which was renewed earlier this month.

Optimal level of inflation: Bank of Canada research suggests that, in a perfect world, the optimal rate of inflation is closer to, or even slightly below, zero. "But we do not live in a perfect world," the Governor said. The models that suggest a lower rate may be preferable do not take into account real-world costs and risks, including the important risk of conducting monetary policy with interest rates at the zero lower bound.

Price-level targeting (PLT): Recent research and theoretical modelling have shown that PLT could potentially deliver gains in terms of increasing both long-term certainty about the price level and short-term macroeconomic stability, and it may merit consideration as a temporary unconventional policy tool in countries faced with extraordinary circumstances. "There are, without question, risks to this approach," the Governor cautioned. "As Bank research has shown ... these approaches could in fact prove destabilizing to the economy and damaging to the central bank's credibility."

Monetary policy and financial stability: The global financial crisis has reinforced the reality that economic stability and financial stability are inextricably linked. "In some exceptional circumstances … monetary policy might itself be the appropriate tool to support financial stability," Governor Carney said, adding, "this last point should not be overstated. The paramount goal of monetary policy in Canada has been, and remains, price stability."

In concluding, the Governor described how the framework is applied under current circumstances. "We make monetary policy in the real world, where shocks are a fact of life," he said. "It is our job to anticipate potential shocks, analyse their impact on economic activity and inflation in Canada, and set monetary policy consistent with achieving the 2 per cent inflation target over time. This ultimately remains the best contribution that monetary policy can make to the economic well-being of Canadians."