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Panel Discussion: Coordinated Policies for Global Liquidity and Robust Growth

Remarks to The Bank of Korea International Conference 2013
4 June 2013
Seoul, Korea

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Basic questions

- Where is there a need for coordination? To what extent do decentralized policies yield the “right” outcome?

- To the extent that coordination may be needed, are existing means of coordination adequate?

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Central bank policies have helped counter private deleveraging

- The collapse of private liquidity through crisis and the subsequent deleveraging process in post-crisis economies exerted powerful contractionary forces on the global economy.

- Central banks in major jurisdictions—including U.S., E.U., Japan, U.K.—cut policy rates to historic lows and have expanded their balance sheets.

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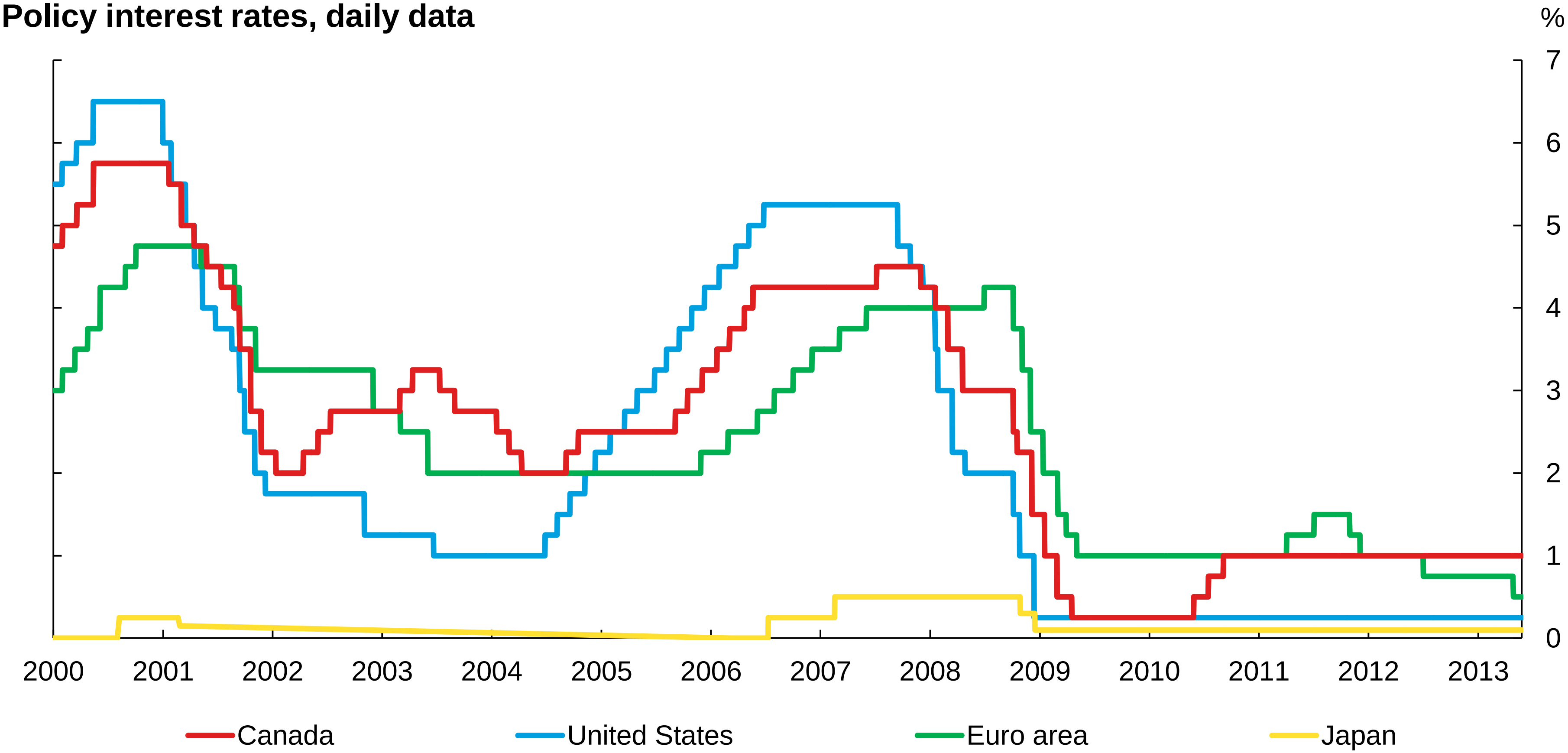
Policy interest rates were cut to historic lows

Policy interest rates, daily data

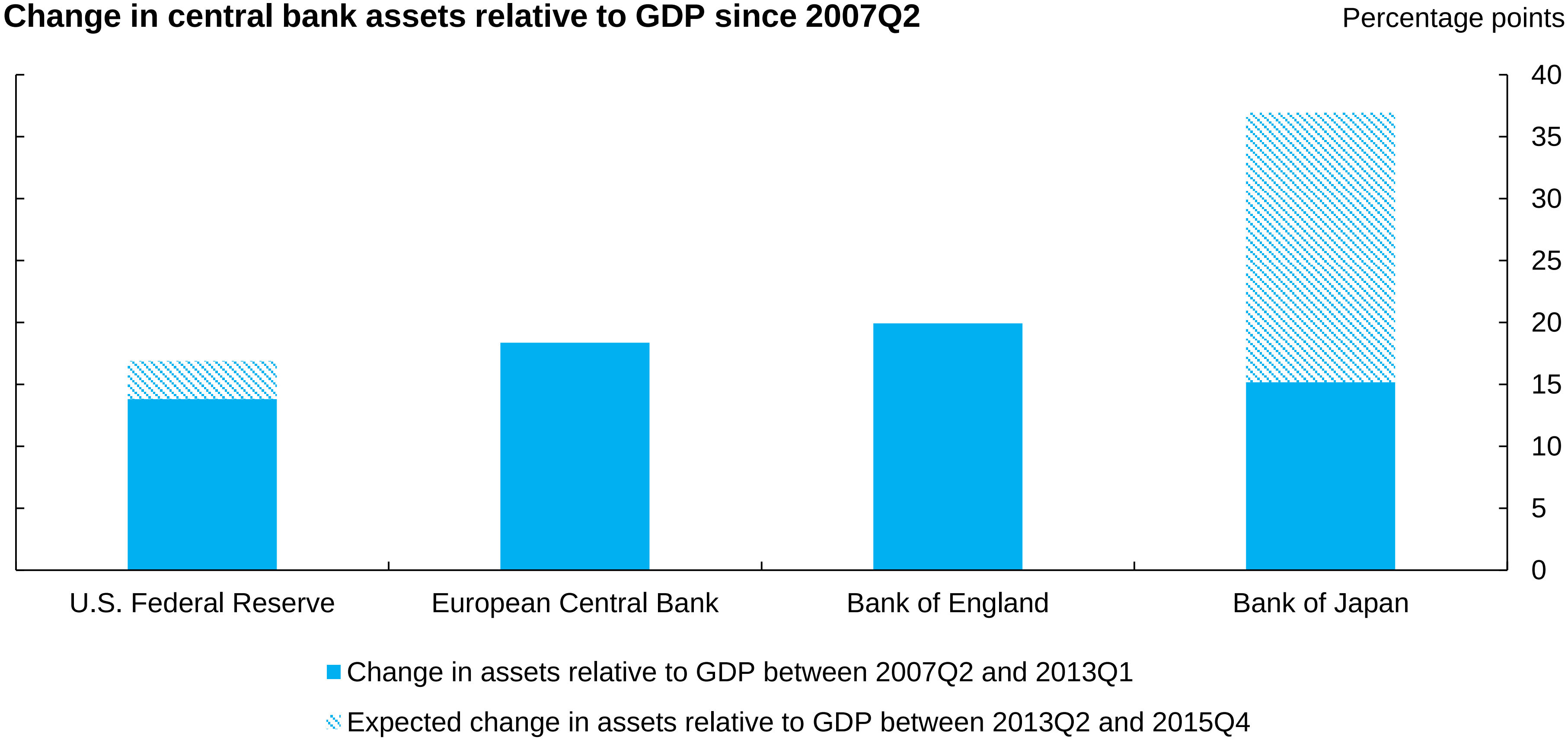


Note: On 5 October 2010, the Bank of Japan changed the target for its policy rate from 0.1 per cent to a range of 0.0 to 0.1 per cent. The U.S. Federal Reserve has been maintaining a target range for its policy rate of 0.0 to 0.25 per cent since 16 December 2008.
Sources: Bank of Canada, U.S. Federal Reserve, European Central Bank and Bank of Japan

Last observation: 29 May 2013

Major central banks have committed to providing substantial unconventional stimulus

Change in central bank assets relative to GDP since 2007Q2



Note: Expected increase in the assets of the U.S. Federal Reserve is based on an average of private sector forecasts. For the Bank of Japan, the expected change in assets is based on the most recent policy announcement. Data for the ECB represent the change between 2007Q2 and 2012Q4.
Sources: U.S. Federal Reserve, U.S. Bureau of Economic Analysis; European Central Bank, Eurostat; Bank of England, U.K. Office for National Statistics; Bank of Japan, Cabinet Office of Japan; and Bank of Canada calculations

Last observations: Euro area, 2012Q4; other countries, 2013Q1

Effects on non-crisis countries

- Expansionary monetary policy to support domestic objectives in post-crisis economies can put upward pressure on other countries' currencies—resulting in appreciation where exchange rates are flexible.

- On balance, however, exceptional easing in post-crisis economies is likely to be beneficial to other countries that were not at the centre of the crisis, since the favourable effects of stronger growth in the major post-crisis economies outweigh the adverse effects of currency appreciation.

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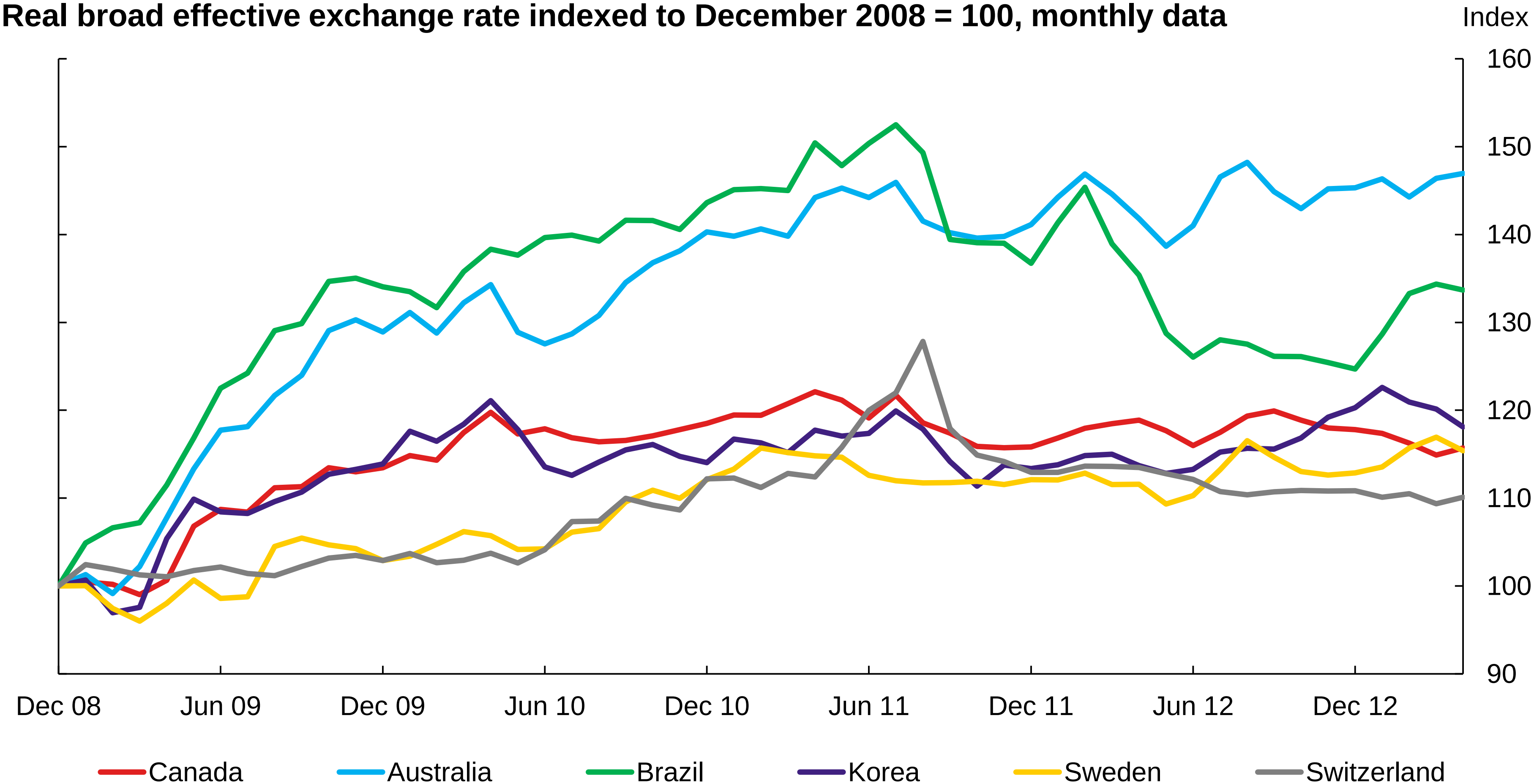
Currencies of non-crisis countries appreciated from their crisis lows

Real broad effective exchange rate indexed to December 2008 = 100, monthly data



Sources: Bank for International Settlements and Bank of Canada calculations

Last observation: April 2013

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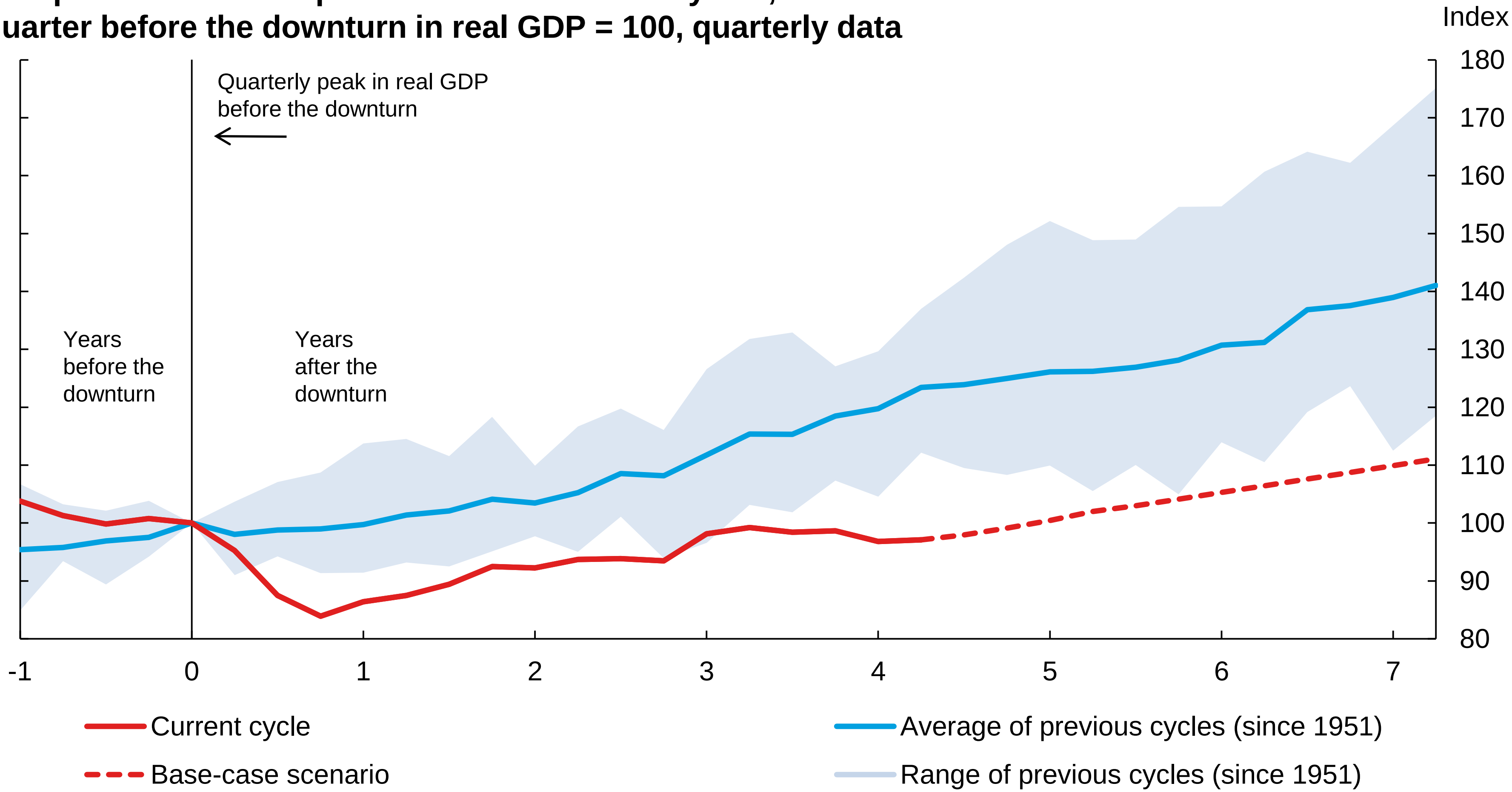
Monetary easing in non-crisis countries results in domestic imbalances

- In some of the non-crisis countries, monetary easing has resulted in a pattern of growth more heavily reliant on domestic demand than on exports.

- There are limits to this growth strategy, as imbalances have appeared in housing markets and the financial system more broadly.
  - Household imbalances in Canada are an example. We are now seeing a constructive evolution of household debt as growth in total household credit has continued to moderate.

Canada's export recovery is the weakest in postwar period

Comparison of real exports across economic cycles; quarter before the downturn in real GDP = 100, quarterly data

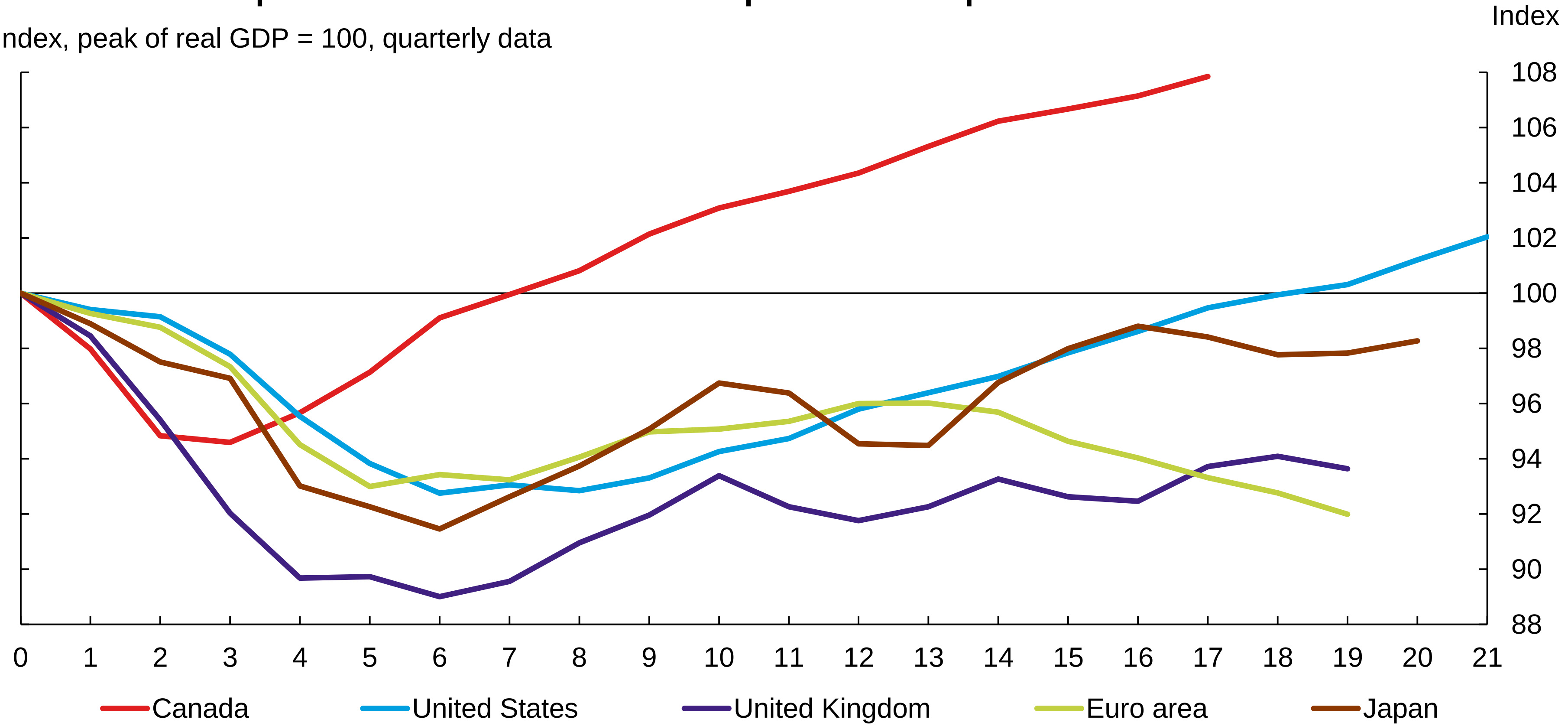


Sources: Statistics Canada and Bank of Canada calculations and projections

Canada has relied on domestic demand

Evolution of real private domestic demand since pre-recession peak

Index, peak of real GDP = 100, quarterly data



Note: Private domestic demand includes consumer and business and residential investment, except for the Euro area, where it includes government investment.
Sources: Statistics Canada, U.S. Bureau of Economic Analysis, Eurostat, Cabinet Office of Japan, U.K. Office for National Statistics, and Bank of Canada calculations

Last observation: 2012Q4 UK and EA; 2013Q1 all others

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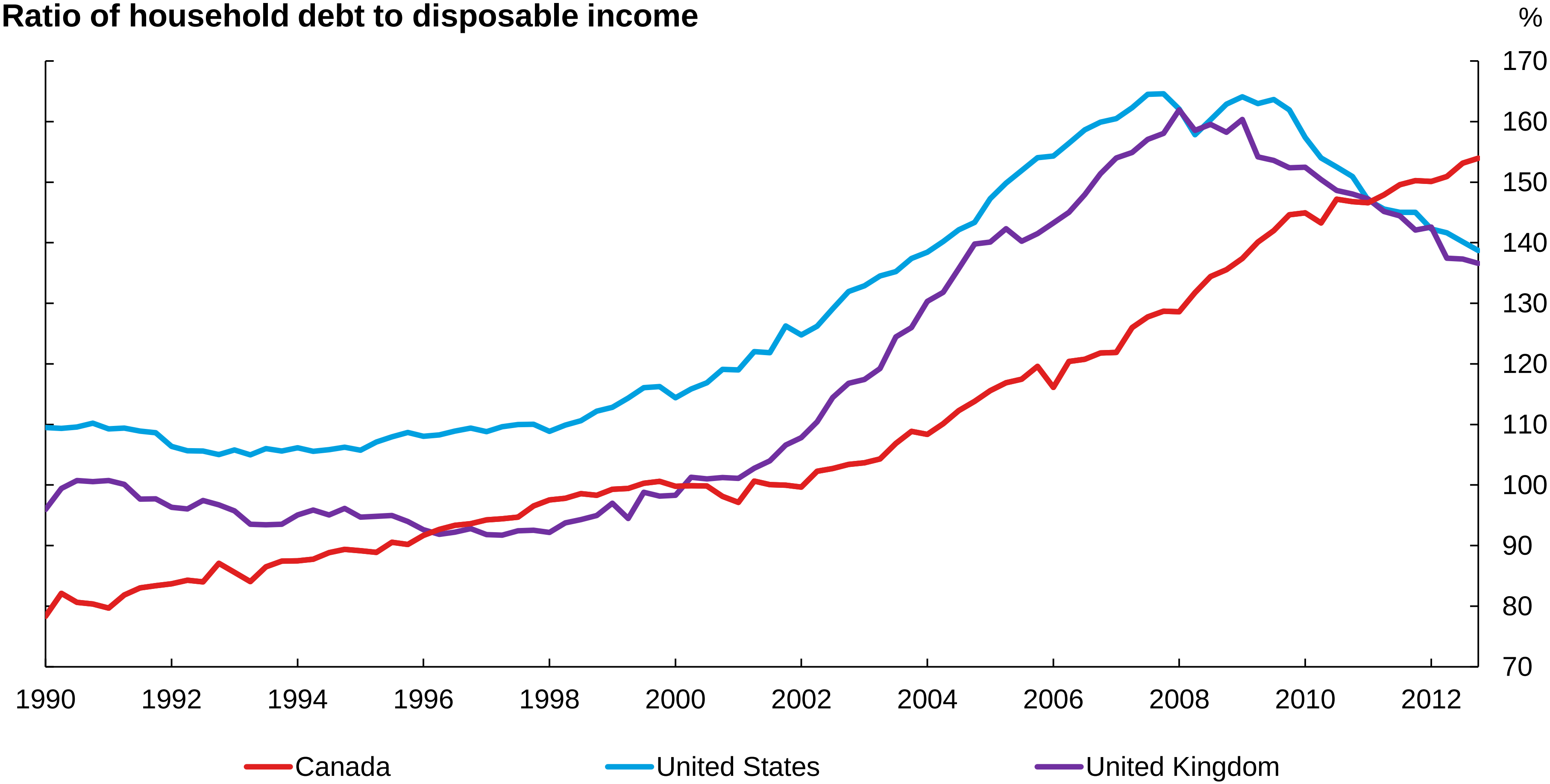
Canadians are now more indebted than the Americans or the British

Ratio of household debt to disposable income



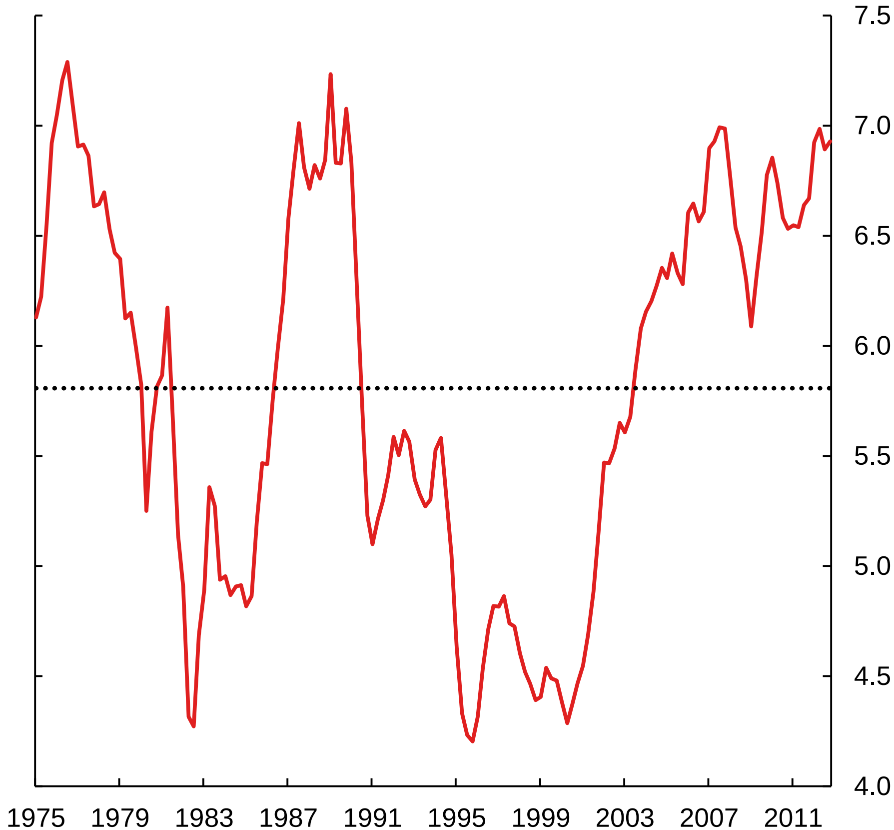
Sources: Statistics Canada (ratio of Canadian household credit market debt to disposable income, adjusted for U.S. concepts and definitions), U.K. Office for National Statistics and U.S. Federal Reserve

Last observation: 2012Q4

Imbalances in Canadian housing markets

The share of residential investment in GDP is elevated

Ratio of nominal residential investment to nominal GDP

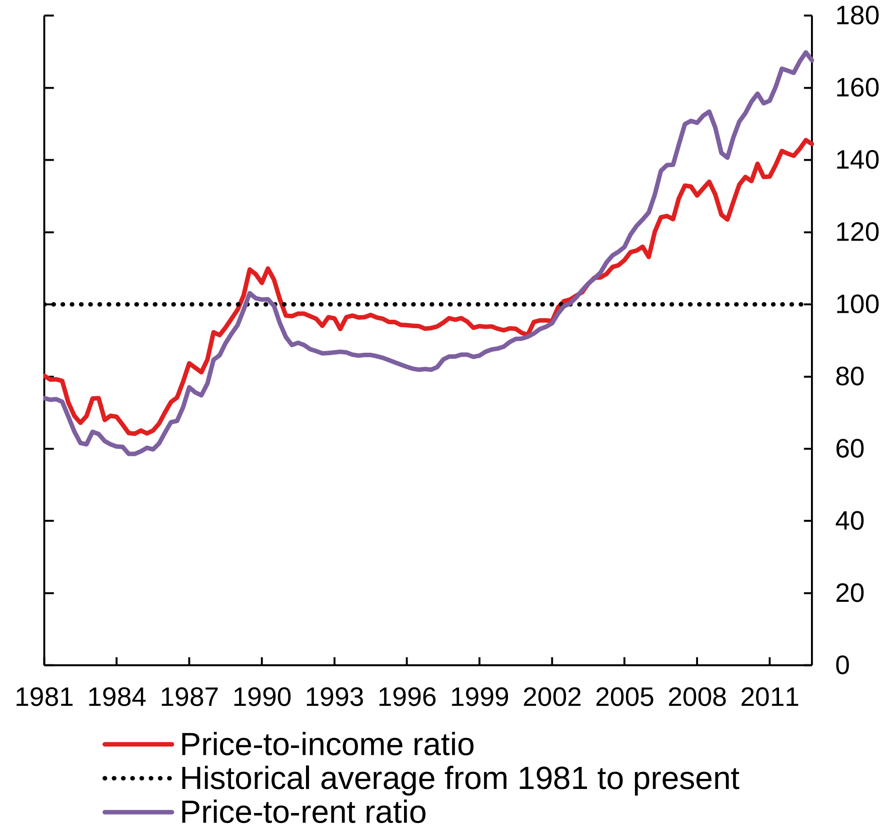


Note: The broken line indicates the historical average from 1975 to the present.
Sources: Statistics Canada and Bank of Canada calculations

Last observation: 2012Q4

House prices are still high relative to income and rents

House price-to-income and price-to-rent ratios



Note: The historical average from 1981 to latest available is set equal to 100.
Sources: Teranet-National Bank, Statistics Canada, Canadian Real Estate Association and Bank of Canada calculations

Last observation: 2012Q4

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Countries with less-flexible exchange rates have responded differently

- For non-crisis countries with less-flexible exchange rates, expansionary monetary policy in post-crisis economies has added to capital inflows.
- If these inflows were unsterilized, they would result in higher inflation and thus real exchange rate appreciation.
- In practice, this has taken place only to a limited degree. To some extent, inflows have been sterilized, accompanied by various restrictions on the financial system.
- From a global perspective, such sterilization partly offsets the effects of the monetary expansion in post-crisis countries

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This is part of the broader problem of external adjustment

- Starting from an unsustainable configuration of savings-investment imbalances, deleveraging is needed in deficit countries, accompanied by a rotation of demand toward domestic demand in surplus countries and supported by real exchange rate adjustment—the “good solution.”

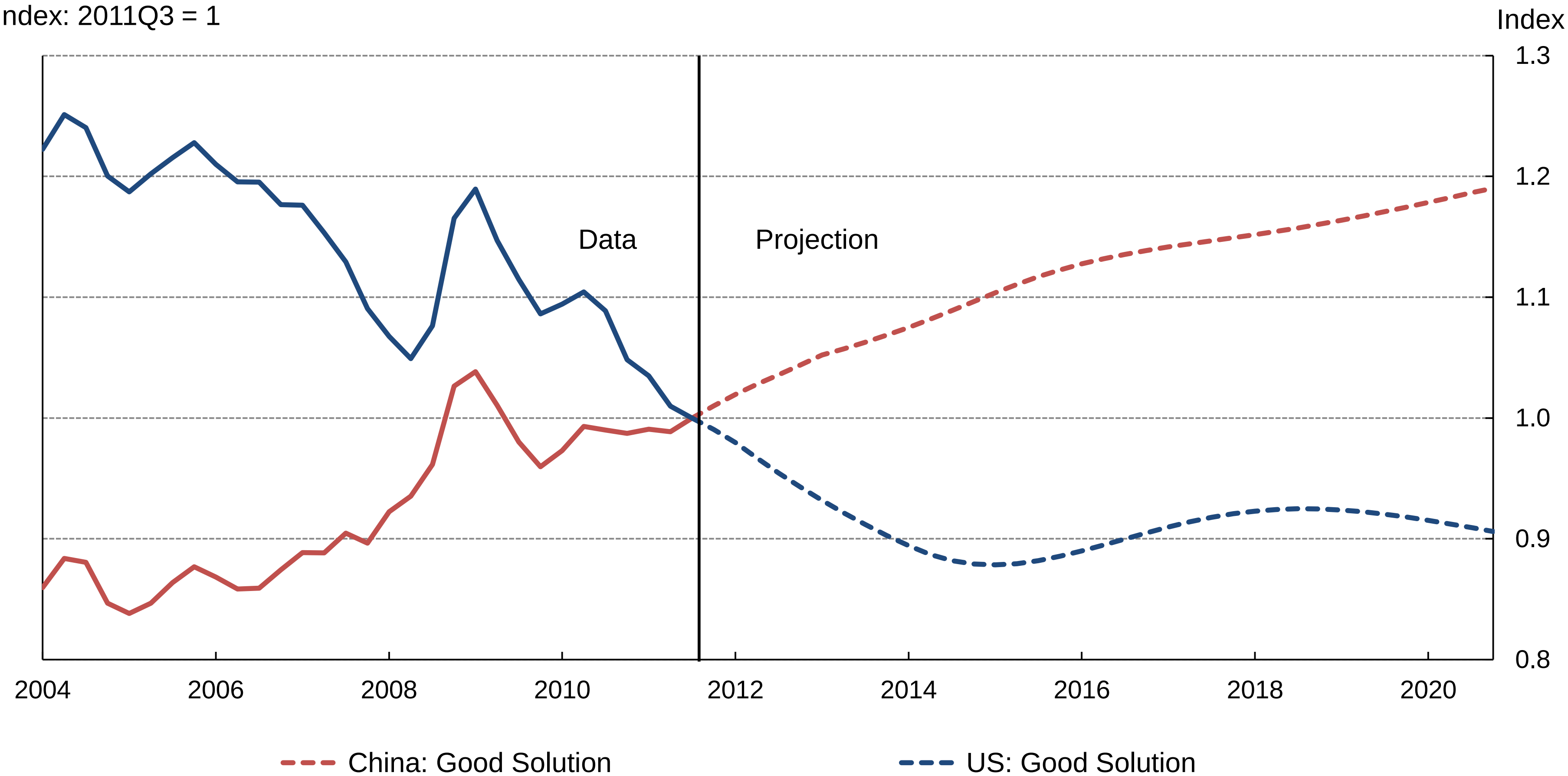
- In the wake of the crisis, market forces have driven deficit countries toward deleveraging.

- But the surplus countries have felt less pressure to bring about a rotation of demand.

The "good" solution: adjustment in exchange rates

Real effective exchange rates in China and the United States

Index: 2011Q3 = 1

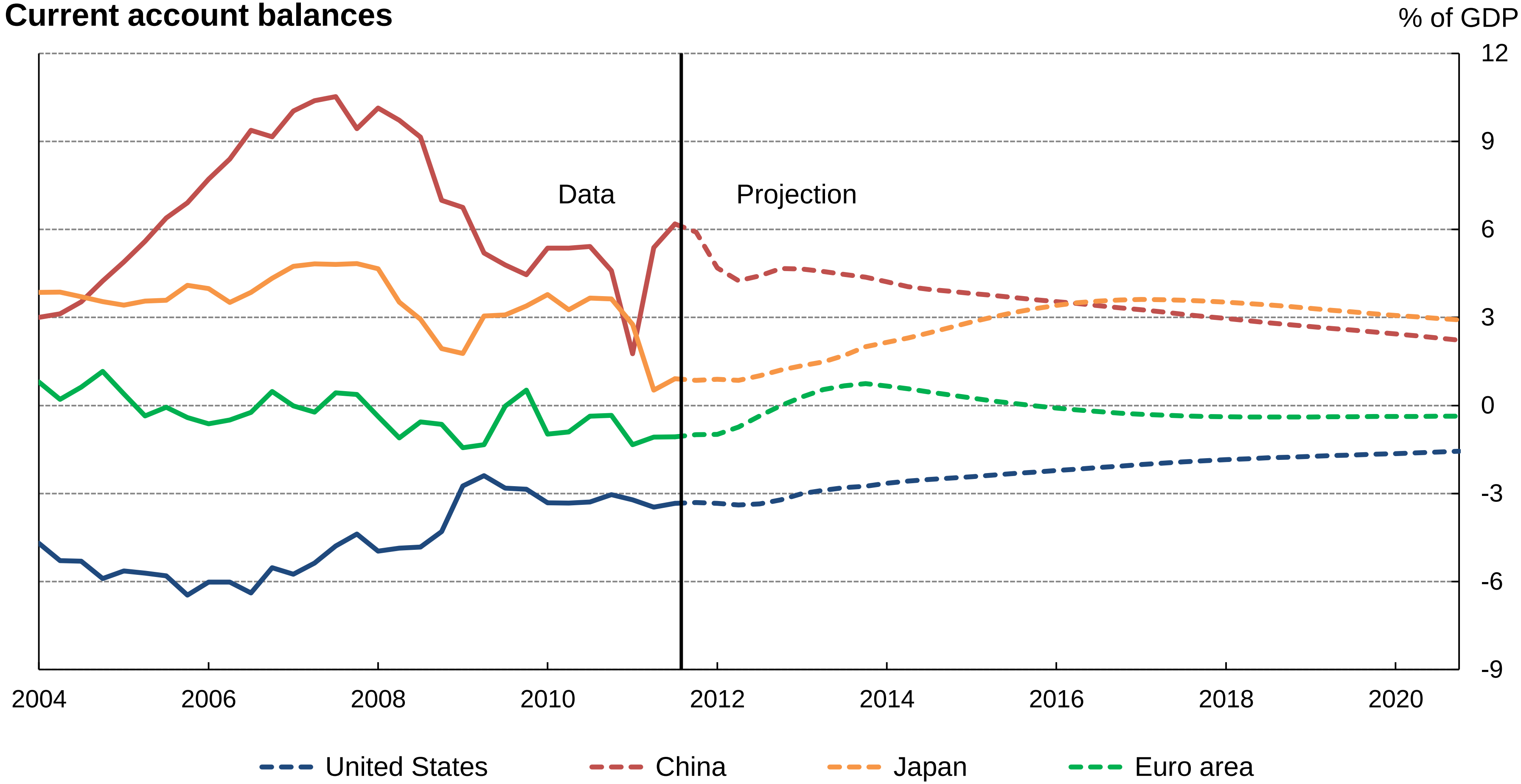


Sources: GMUSE and BoC-GEM-Fin simulations

Last observation: June 2011

The "good" solution: global imbalances resolved

Current account balances



Sources: GMUSE & BoC-GEM-Fin simulations

Last observation: June 2011

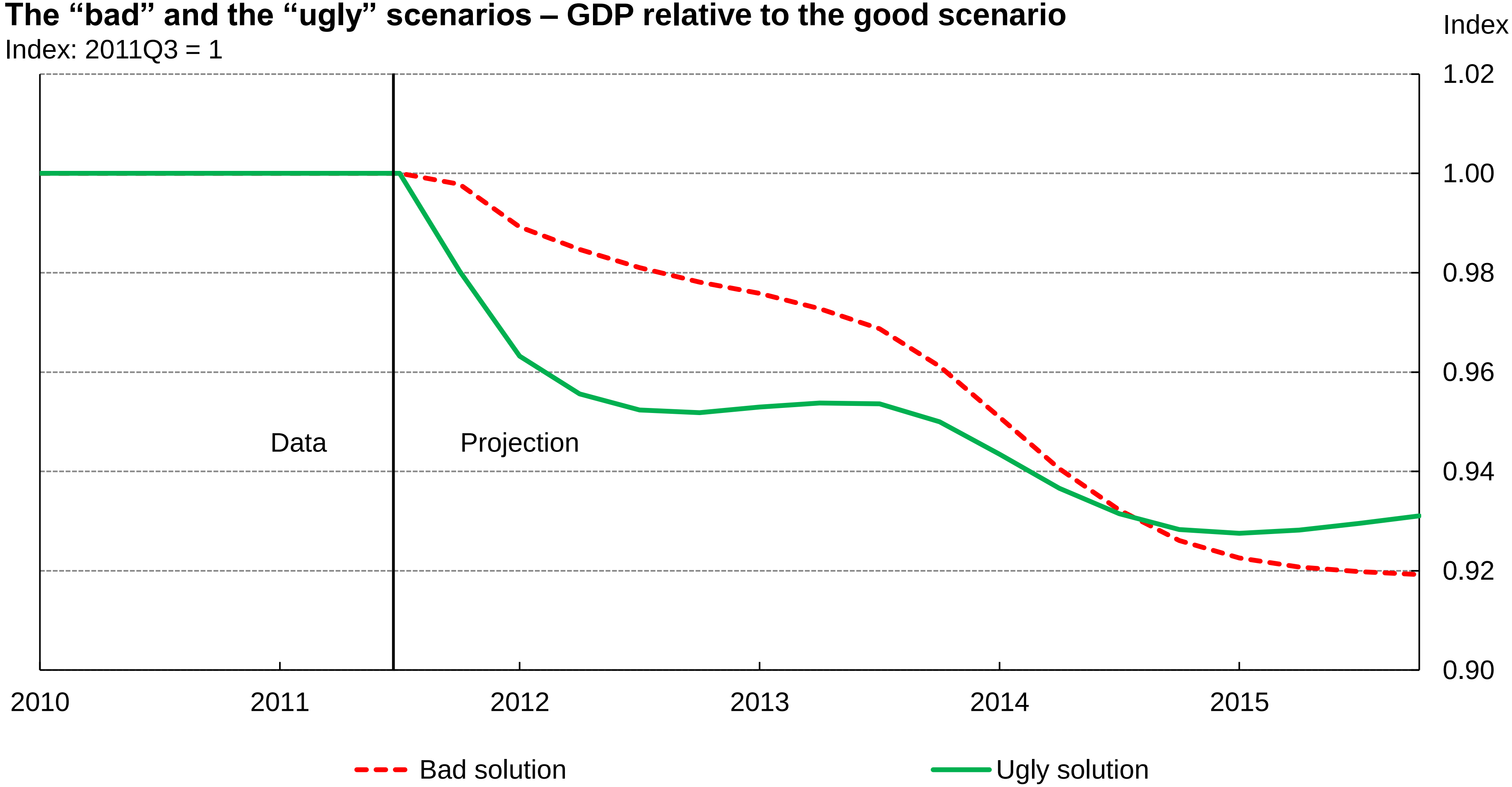
Delayed or asymmetric adjustment

- In the “bad” scenario, adjustment is delayed and real exchange rates do not adjust.
  – Bank of Canada estimates that $6 trillion in global output would be lost.

- Asymmetric adjustment is the “ugly” scenario: deleveraging in deficit countries, but no rotation of demand in surplus countries.
  – Output losses may be even larger.

Doing half the job could be even worse...

The "bad" and the "ugly" scenarios – GDP relative to the good scenario
Index: 2011Q3 = 1



Sources: GMUSE and BoC-GEM-Fin simulations

Last observation: June 2011

Coordination in the G-20 Framework

- The G-20's Framework for Strong, Sustainable and Balanced Growth (Toronto 2010 Summit) is intended to provide a focal point for appropriate policies.

- The G-20 have established a peer-review mechanism to track progress.

- The IMF's bilateral and multilateral surveillance both work toward broadly similar objectives.