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Underwhelming Recovery Poses Challenges for Monetary Policy, Says Bank of Canada Senior Deputy Governor Carolyn Wilkins

Toronto— The underwhelming recovery from the global financial crisis has challenged policy-makers to better understand the factors weighing on growth and to deal with greater uncertainty, Bank of Canada Senior Deputy Governor Carolyn Wilkins said in Toronto today.

To conduct monetary policy, the Bank needs to assess how much of the slow growth is due to the hangover from an unprecedented crisis and how much is due to structural factors, Ms. Wilkins said in remarks to the CFA Society Toronto. The Bank also needs to know how these factors are affecting the neutral rate of interest in order to calibrate policy.

“The bottom line is that potential output growth in Canada and other industrialized economies will be lower than it was in the years leading up to the crisis,” Senior Deputy Governor Wilkins said. "We also think that the neutral rate of interest is lower.”

The neutral interest rate enables the economy to operate at full capacity with stable inflation after cyclical forces have dissipated. The Bank estimates that the rate for Canada now stands at between 3 and 4 per cent, down from a range of 4 1/2 to 5 1/2 per cent in the mid-2000s, the Senior Deputy Governor said. With the overnight rate at 1 per cent, that means monetary policy is stimulative.

Disentangling cyclical and structural factors is never an exact science, Ms. Wilkins said. “Our approach is to consider the main sources of uncertainty in our deliberations on how best to achieve our inflation target."

“When we do this, it is clear that continued monetary stimulus is needed to return the Canadian economy to sustainable growth and to maintain inflation at target,” Ms. Wilkins said. "And, depending on the evolution of data, it is possible that persistent headwinds will mean that some degree of stimulus will be required even after the output gap is closed to keep inflation at target."

Bank of Canada policy-makers will also continue to take into account the impact that low interest rates might have on the country’s financial stability, she added.