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Bank of Canada Working to Integrate Financial Stability into Monetary Policy, says Governor Poloz

LIMA, PERU — The Bank of Canada is taking a risk-management approach to integrating financial stability concerns into monetary policy, Governor Stephen S. Poloz said today.

In a speech to the meeting of the Institute of International Finance in Lima, Peru, the Governor said financial stability issues add a new dimension of risk to the many uncertainties that are already present in the conduct of monetary policy. “A general-equilibrium model containing a grand synthesis of real and financial variables doesn’t exist and isn’t likely to,” the Governor said. As a result, the Bank sets monetary policy so that the range of likely outcomes falls into a zone where policy-makers are confident of achieving the inflation target over a reasonable time frame and that financial stability risks will evolve in a constructive way.

The Governor explained that the Bank’s flexible framework gives it the option of taking more time to return inflation to target so as not to worsen financial stability concerns. However, he stressed that this “does not mean that the central bank will adjust policy to try to lean against every emerging financial imbalance.” The Bank’s primary mission of inflation targeting must always take precedence, he said.

The Bank sees monetary policy as the last line of defence against financial stability concerns, the Governor said. The joint responsibility of borrowers and lenders, sound financial sector policies and properly implemented macroprudential rules should all come before central bank action, he said.

The Governor also told the meeting that it is crucial for countries and financial institutions to implement the rules contained in the Basel III package of reforms, which have made the world a safer place.

“For financial institutions, this is a long and difficult path, but the stakes are too high to contemplate leaving the job incomplete,” the Governor said.