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Bank of Canada Focusing Research on Integrating Monetary Policy and Financial Stability, says Governor Poloz

WASHINGTON, D.C. — The Bank of Canada is exploring the links between financial stability considerations and traditional central bank approaches to inflation targeting as part of its risk-management approach to achieving its monetary policy goals, Governor Stephen S. Poloz said today.

As the Bank of Canada works toward renewing its inflation-targeting agreement with the federal government next year, “we will continue to strive for a better understanding of the interactions between monetary policy and financial stability,” the Governor told the annual meeting of the National Association for Business Economics in Washington, D.C. “I expect to see a large amount of groundbreaking research that will shed light on various aspects of this relationship.”

Governor Poloz 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,” he 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 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, Governor Poloz 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.