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Promoting Canada's economic and financial well-being

Remarks to the Department of Economics, University of Regina

Regina, Saskatchewan

24 November 2015

Lynn Patterson
Deputy Governor
Bank of Canada

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Overview

What does the Bank of Canada do?

Global and Canadian economic outlook

Mandate

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The Bank's mandate

The mandate of the Bank of Canada is to contribute to the economic well-being of Canadians.

Four key responsibilities:

- Monetary policy
- Financial system
- Currency
- Funds management

Key responsibilities: Monetary policy

Our objective:

To safeguard confidence in the value of money by keeping inflation low, stable and predictable.

- target of 2 per cent established in agreement with the federal government

Benefits:

- greater certainty of future buying power
- lower interest rates
- lower unemployment rate and more-stable economic growth

Renewal of the inflation-targeting agreement in 2016

The inflation-targeting agreement between the federal government and the Bank is renewed every five years.

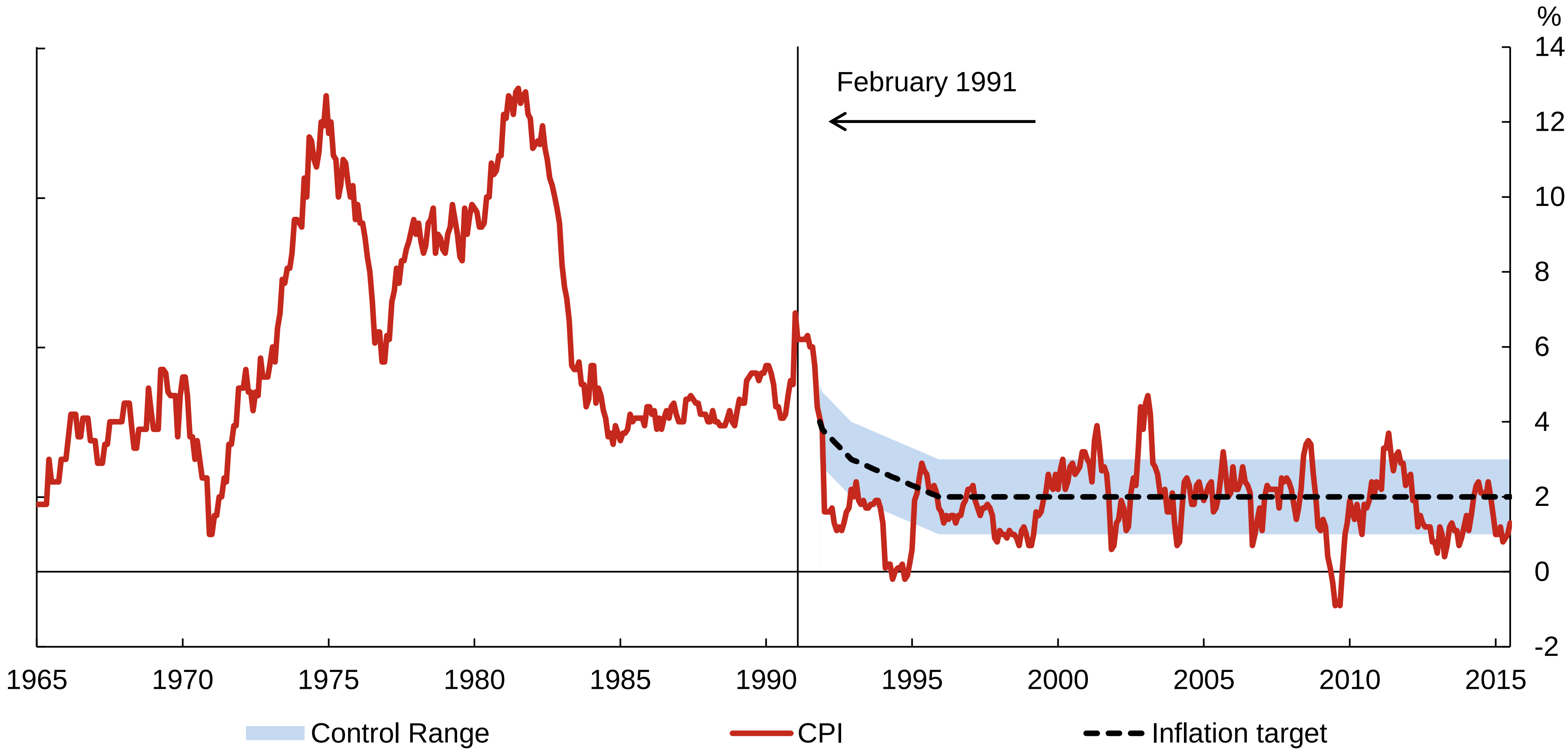
Three main questions for 2016 renewal:

- Is 2 per cent the optimal level of the inflation target?
- How should monetary policy integrate financial stability considerations?
- Should CPIX continue to be our main guide?

More information at http://www.bankofcanada.ca/core-functions/monetary-policy/renewing-canadas-inflation-control-agreement/

Monetary policy: On target

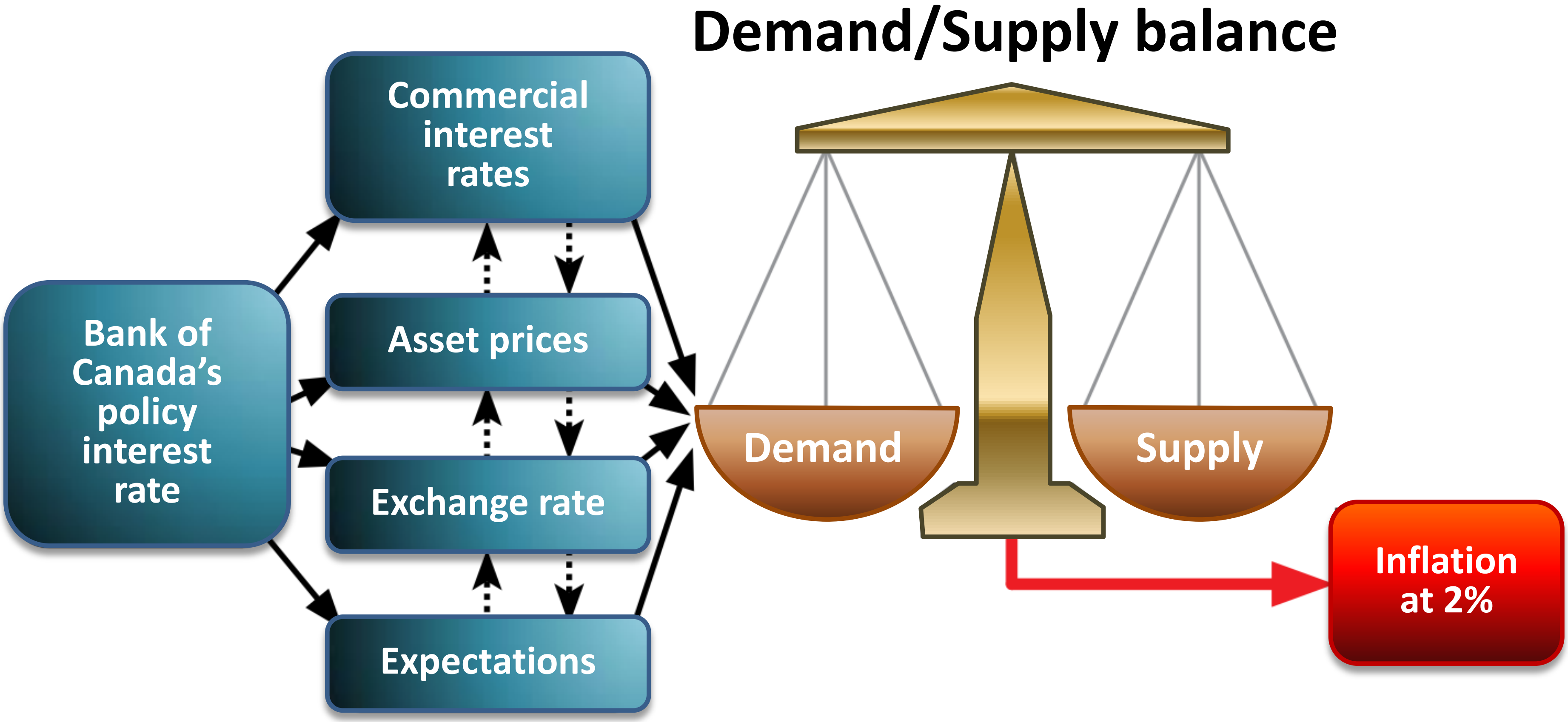
12-month rate of increase, monthly data



Sources: Statistics Canada and Bank of Canada calculations

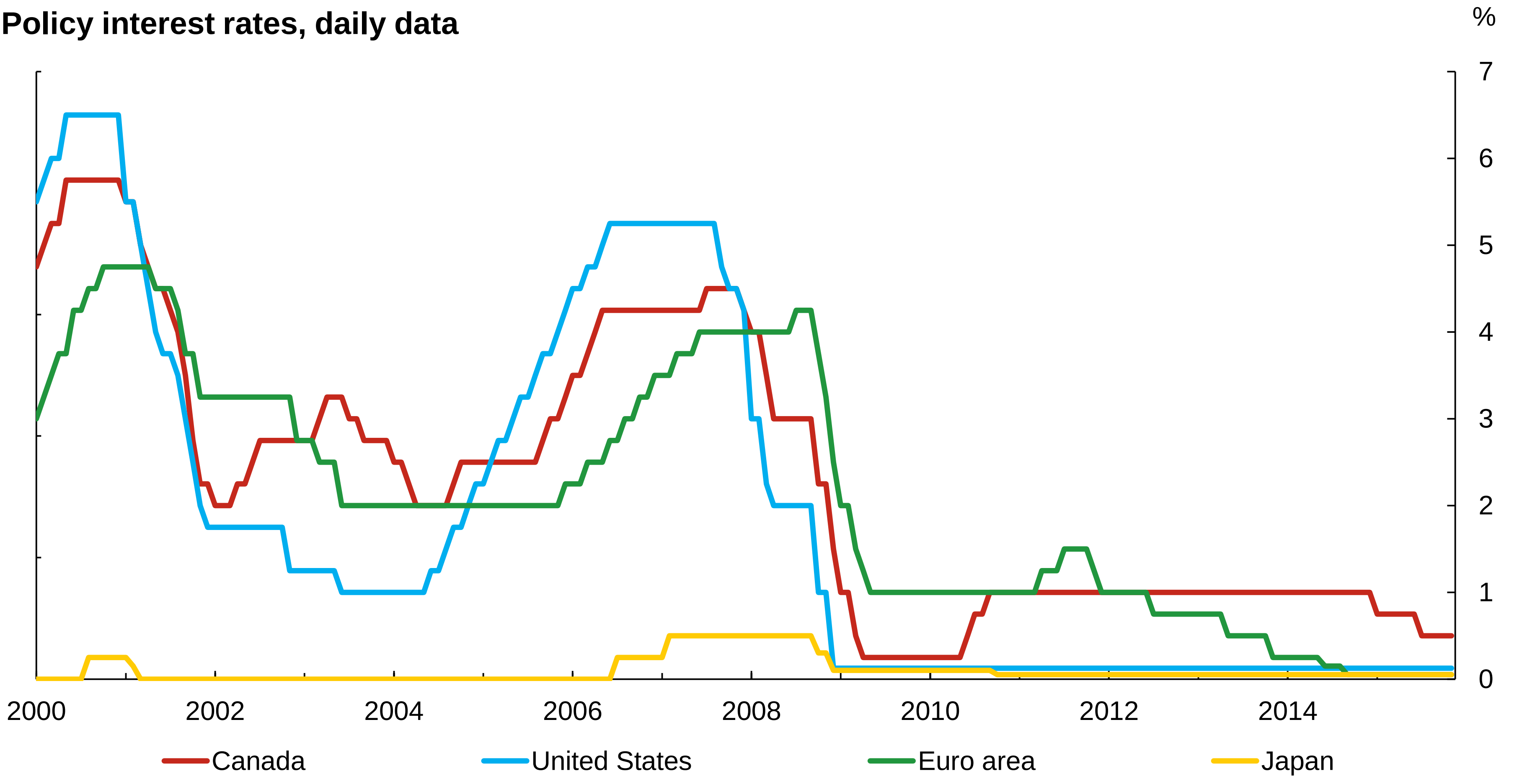
Last observation: July 2015

The transmission of monetary policy



Central bank policy rates at historic lows

Policy interest rates, daily data



Sources : Bank of Canada, U.S. Federal Reserve, European Central Bank and Bank of Japan

Last observation: 17 November 2015

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Key responsibilities: Financial system

Our objective:

To promote the stability and efficiency of the financial system

Canada’s financial system includes

- financial institutions
- financial markets and infrastructure
- clearing and settlement systems

The Bank shares responsibility for financial stability with other regulatory authorities.

Principal activities to promote stability of financial system

The Bank

- provides liquidity and acts as lender of last resort
- oversees systemically important financial market infrastructures and prominent payment systems
- contributes to development of policies governing the financial system
- assesses vulnerabilities and risks
  - publishes findings in the *Financial System Review*

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Key risks in the June *Financial System Review*

The Canadian financial system is robust, but can still be subject to important risks, such as

- household financial stress and a sharp correction in house prices
- a sharp increase in long-term interest rates
- stress emanating from China and other emerging-market economies
- financial stress from the euro area

Key responsibilities: Currency

Our objective:

To provide Canadians with bank notes they can use with confidence.

- Fewer than 30 counterfeits detected annually per million notes in circulation

- Polymer notes are secure, durable, innovative and easy to handle.
- Demand for bank notes continues to grow at the same rate as the economy.
- We have launched a research program on digital currency.

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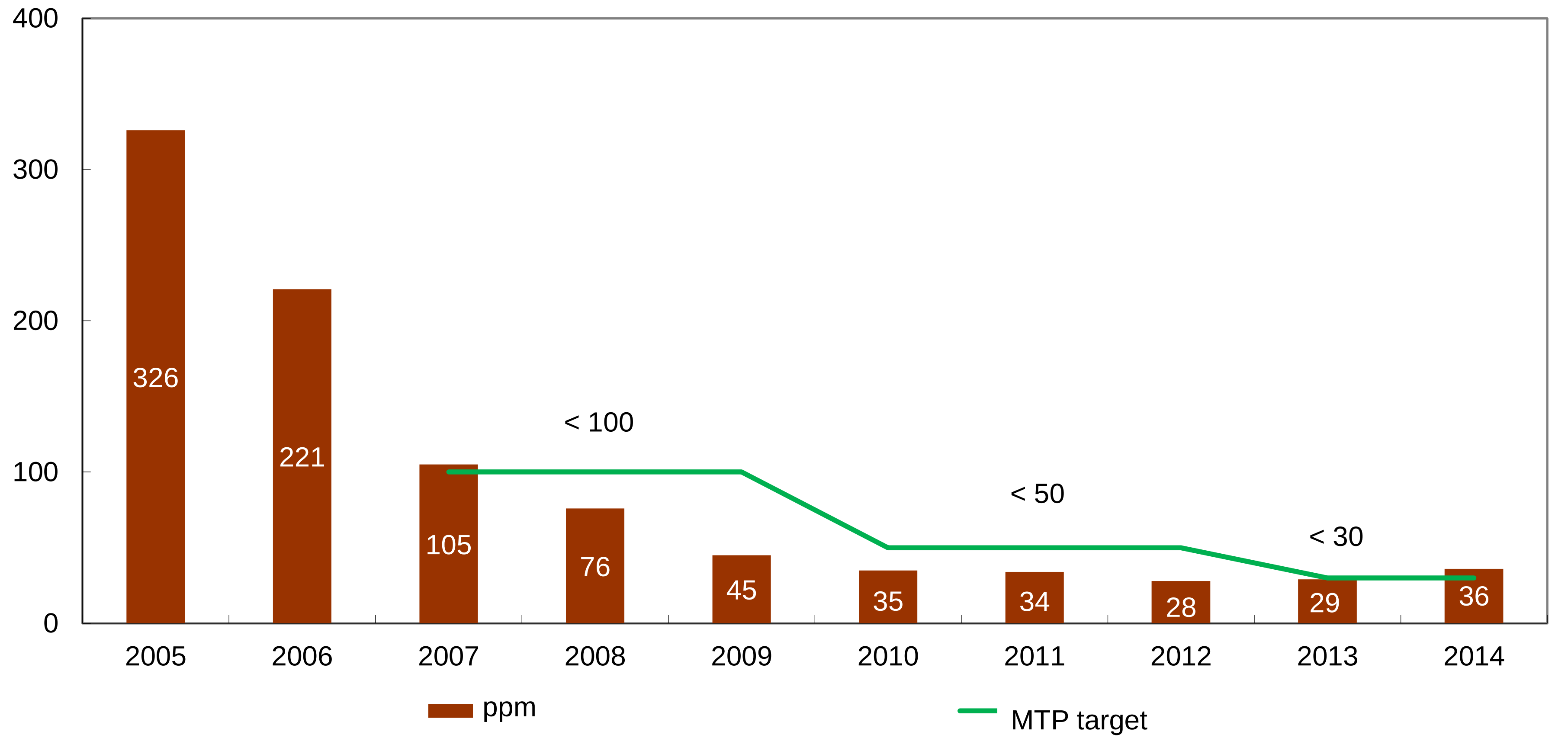
Counterfeiting has fallen to very low levels

Number of counterfeit bank notes detected per million notes in circulation*

Parts per million (ppm)



* Target for the 2013–15 medium-term plan is below 30 ppm.
Source: Bank of Canada

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Key responsibilities: Funds management

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Our objective:
To act as fiscal agent and provide banking services to the federal government and other key players in the financial system

Manage Canada's foreign exchange reserves and federal government's cash balances as well as public debt in collaboration with the Department of Finance

Provide the means of final settlement of daily flows of payments among financial institutions

Canada Savings Bonds Program

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Economic outlook

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Highlights

- Global economy weaker in 2015, but will rebound in 2016 & 2017
  - China slowing, dampening oil and other commodity prices
  - U.S. recovery is gaining traction boosting CDN exports
- Canada adjusting to oil/commodity price decline, with easier financial conditions: lower borrowing rates and lower Canadian dollar
- Oil shock most intense in H1, compounded by temporary factors
- Growth in Canada picks up above potential starting in 2015H2, led by non-energy exports and investment. Output gap closes mid-2017
- Core inflation will hover ~ 2% and total CPI inflation has troughed, near 1%. Both will converge sustainably to 2% as output gap closes

Global overview

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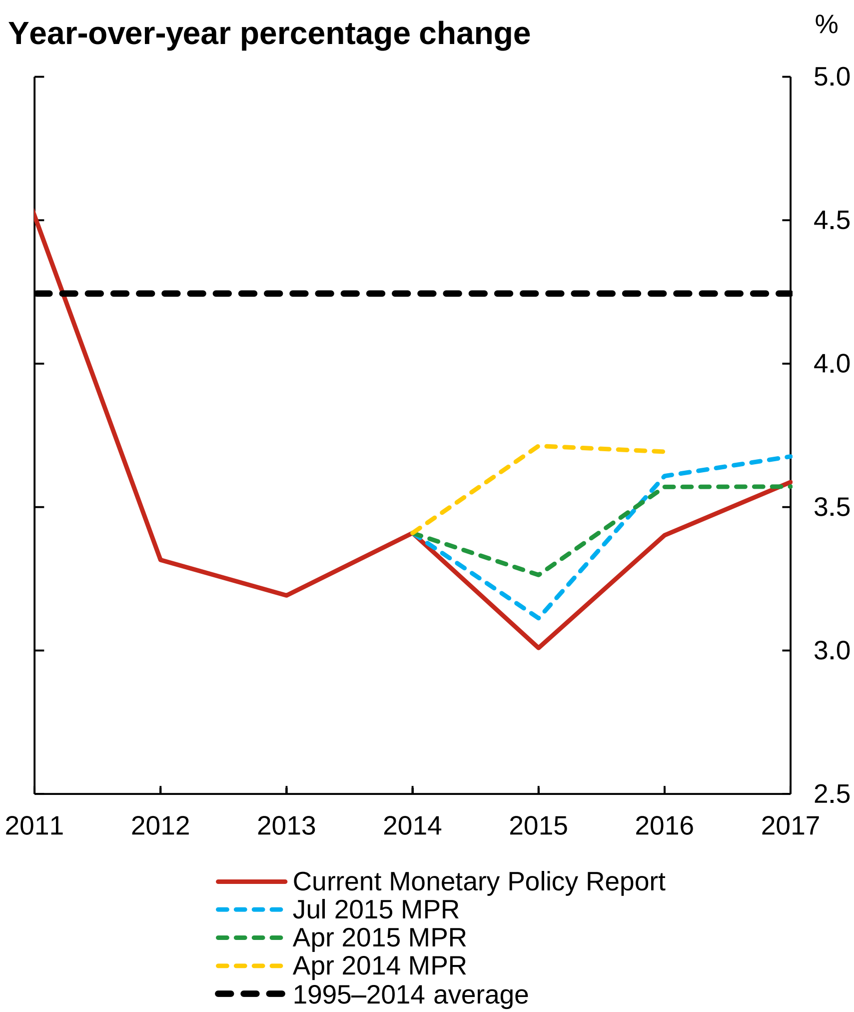
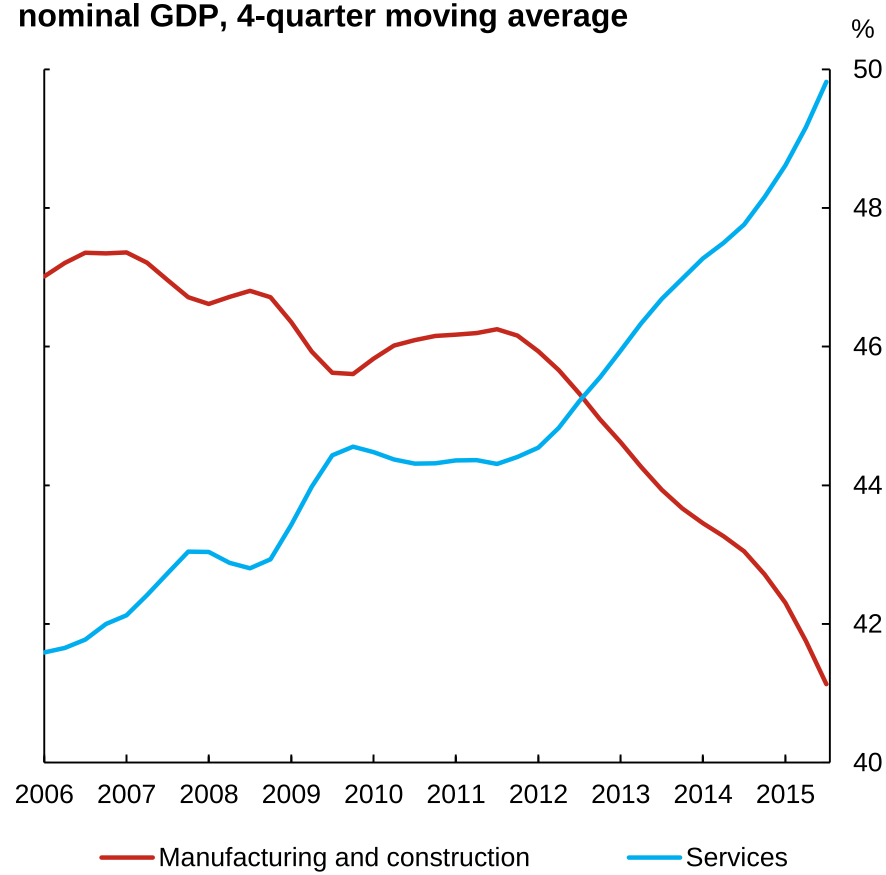
Global growth on a lower trajectory





Note: Services are being proxied by output in the tertiary sector.
Source: National Bureau of Statistics of China

Last observation: 2015Q3

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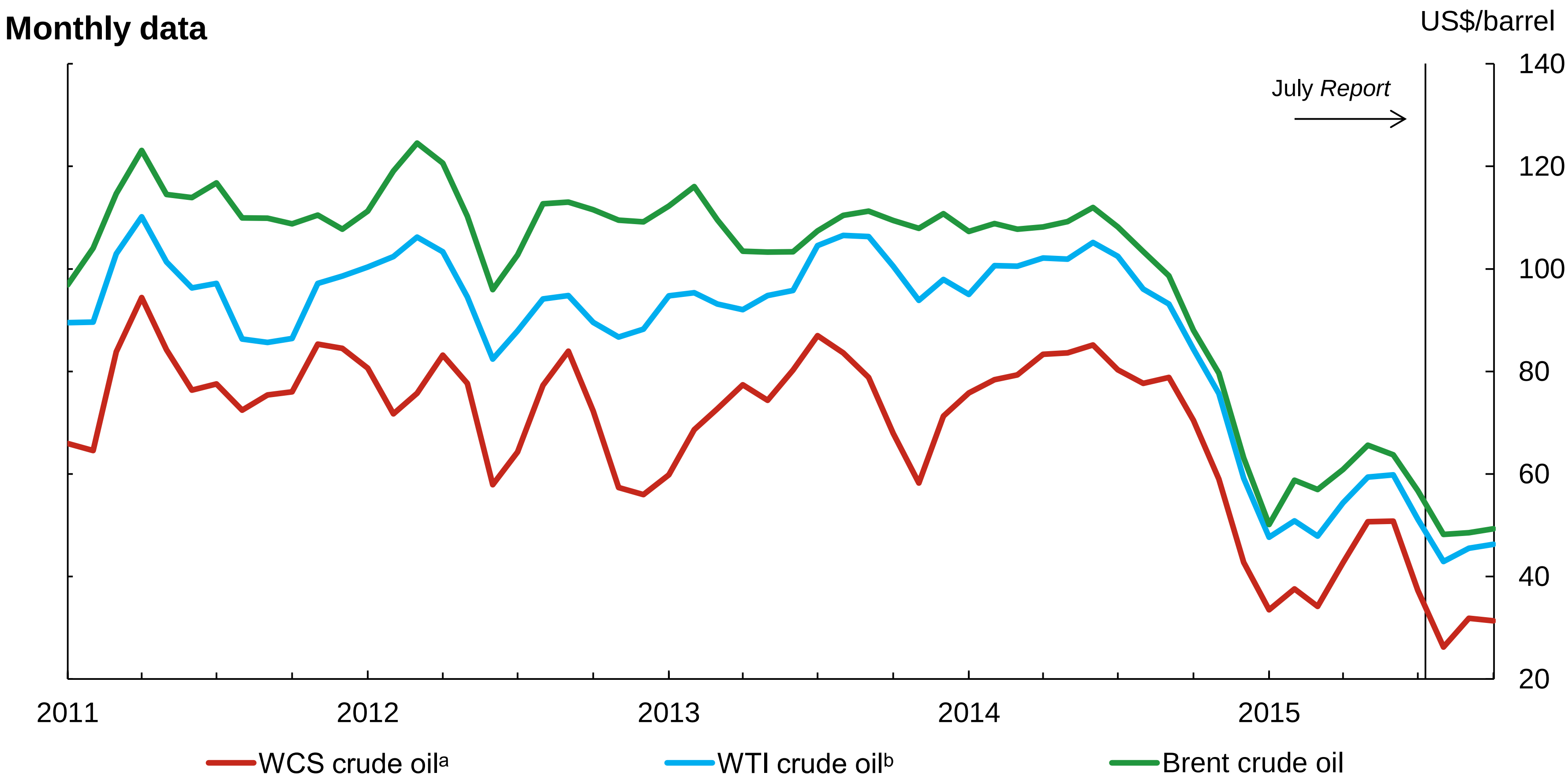
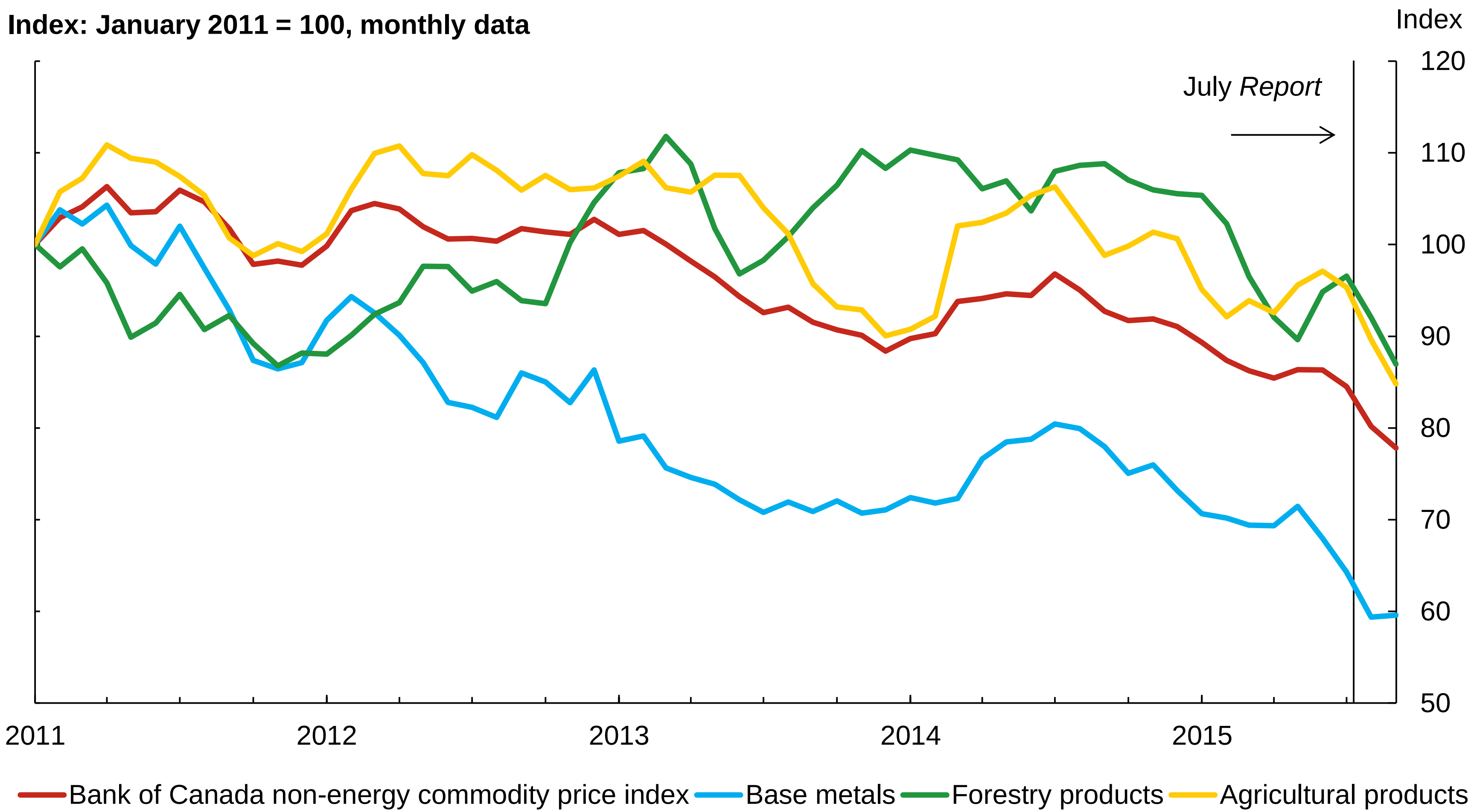
Oil prices have fallen further, driven by demand/supply factors



a. WCS refers to Western Canada Select.
b. WTI refers to West Texas Intermediate
Sources: Haver Analytics and Bloomberg

Last observation: October 2015

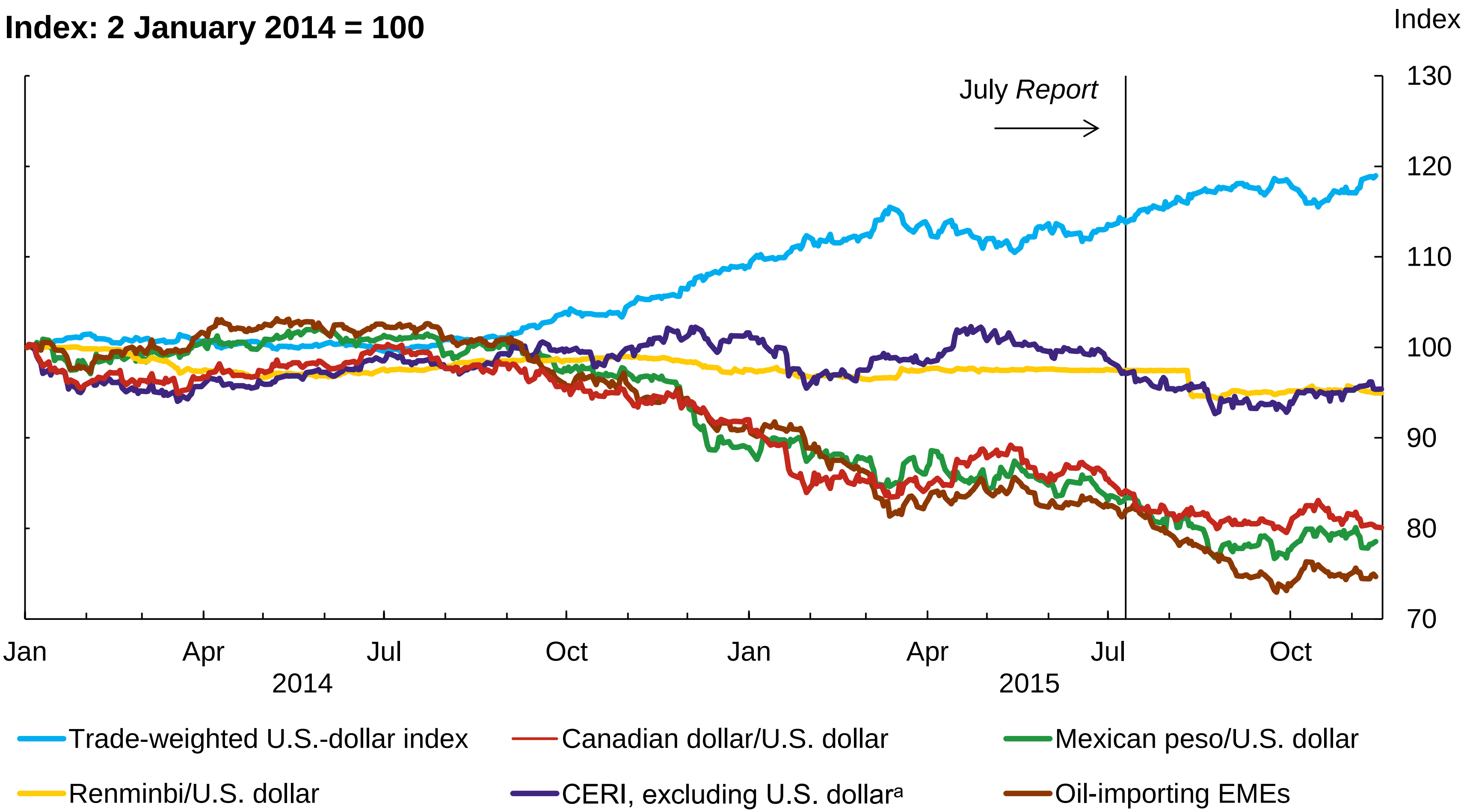
Non-energy commodity prices have weakened further



Source: Bank of Canada

Last observation: September 2015

The U.S. dollar appreciation continues



a. The Canadian-dollar effective exchange rate index (CERI) is a weighted average of bilateral exchange rates for the Canadian dollar against the currencies of Canada's major trading partners. A rise indicates an appreciation of the Canadian dollar.

Sources: National central banks, the financial press and Bank of Canada calculations

Last observation: 16 November 2015

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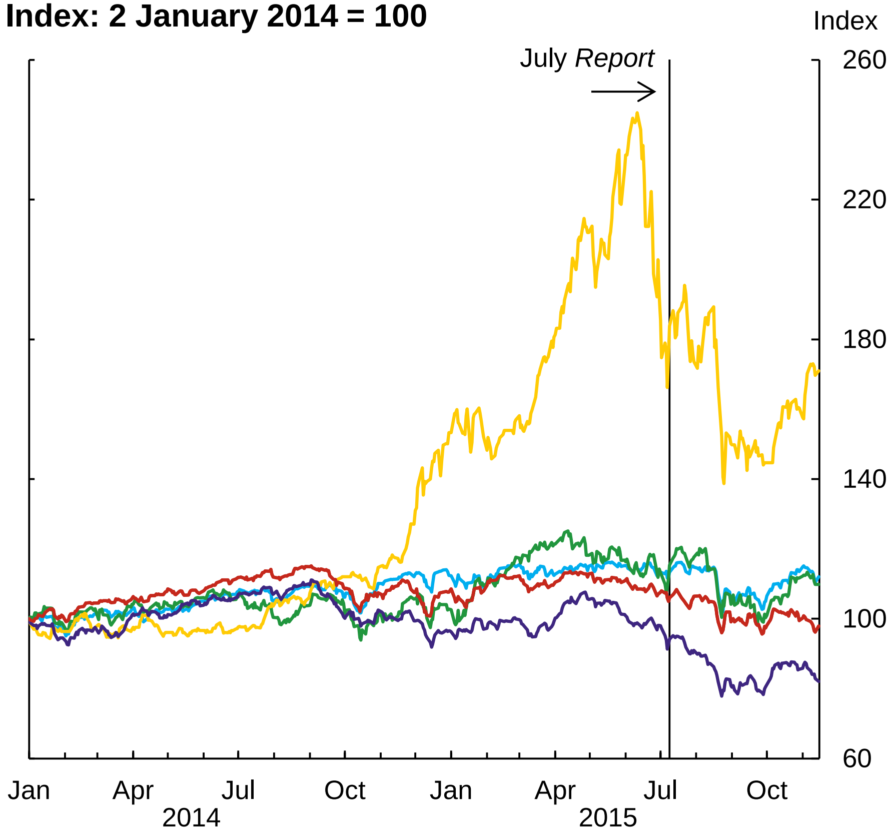
Financial conditions have deteriorated

Index: 2 January 2014 = 100

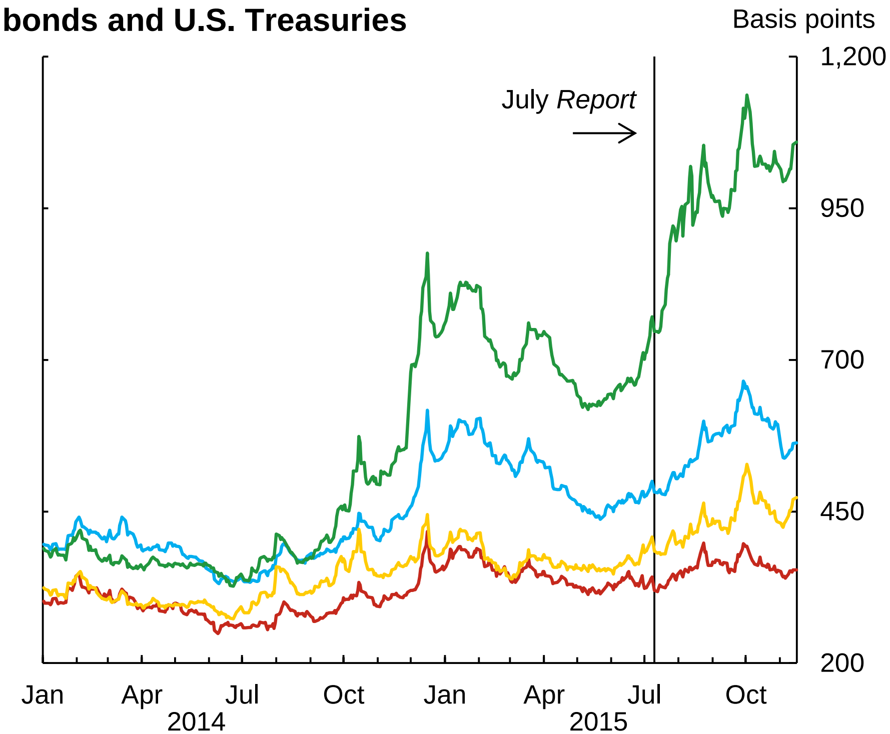


Canada—S&P/TSX Composite
Euro area—STOXX 50
MSCI Emerging Markets
United States—S&P 500
China—SSE Composite

Source: Bloomberg

Last observation: 16 November 2015

Options-adjusted spreads between high-yield bonds and U.S. Treasuries



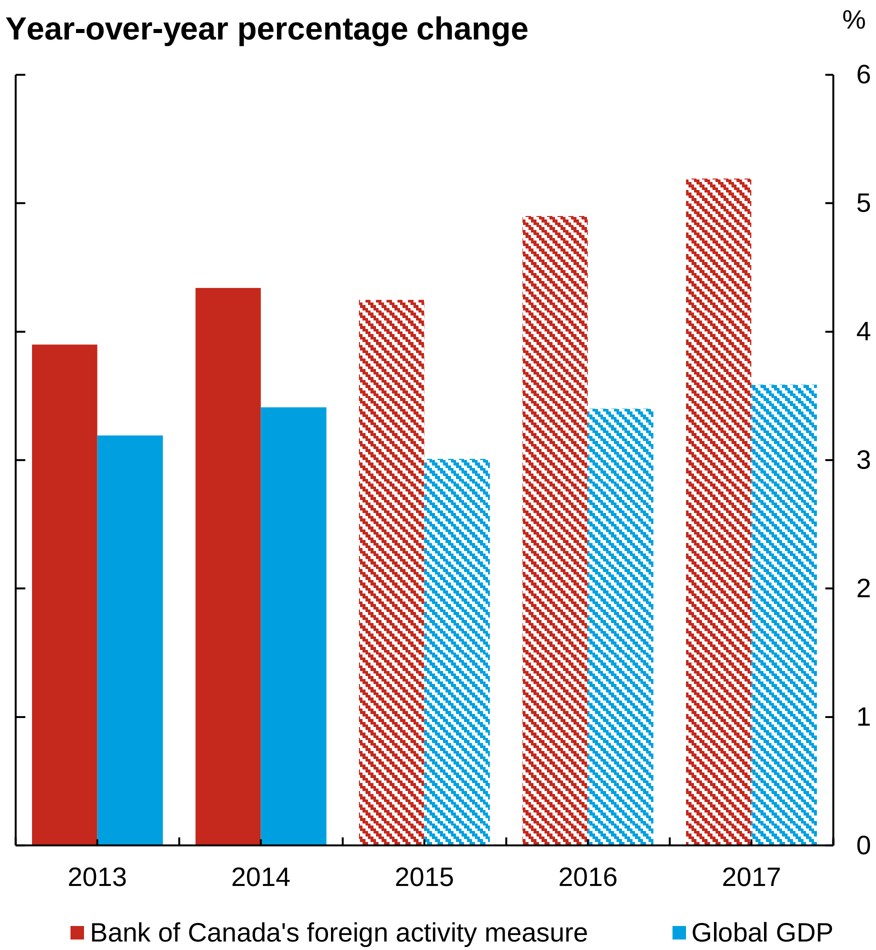
Emerging-market sovereigns
Emerging-market corporates
U.S. high-yield energy corporates
U.S. high-yield non-energy corporates

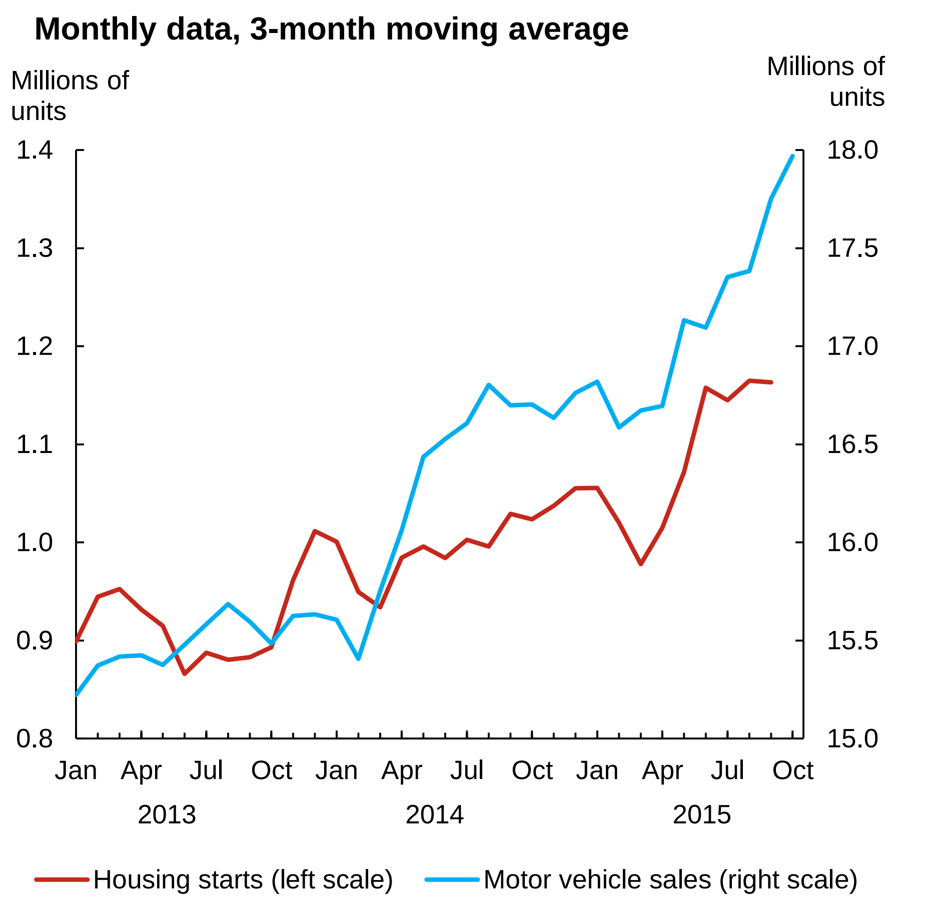
Note: The emerging-market corporate bond index consists of 43 per cent investment-grade bonds and 57 per cent high-yield bonds.

Source: Bank of America Merrill Lynch

Last observation: 16 November 2015

Strong growth in U.S. private domestic demand





Sources: U.S. Census Bureau and U.S. Bureau of Economic Analysis

Last observation: Housing starts, September 2015; motor vehicle sales, October 2015

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Summary: Global growth outlook

	Share of global GDP (%)	Projected growth (per cent)		
		2015	**2016**	**2017**
United States	16	2.5	2.6	2.5
Euro area	12	1.5	1.5	1.5
Japan	4	0.6	0.8	0.7
China	17	6.8	6.3	6.2
Oil-importing EMEs	33	3.2	3.8	4.2
Rest of the World	18	1.3	2.7	3.2
World	**100**	**3.0**	**3.4**	**3.6**

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Canadian economy

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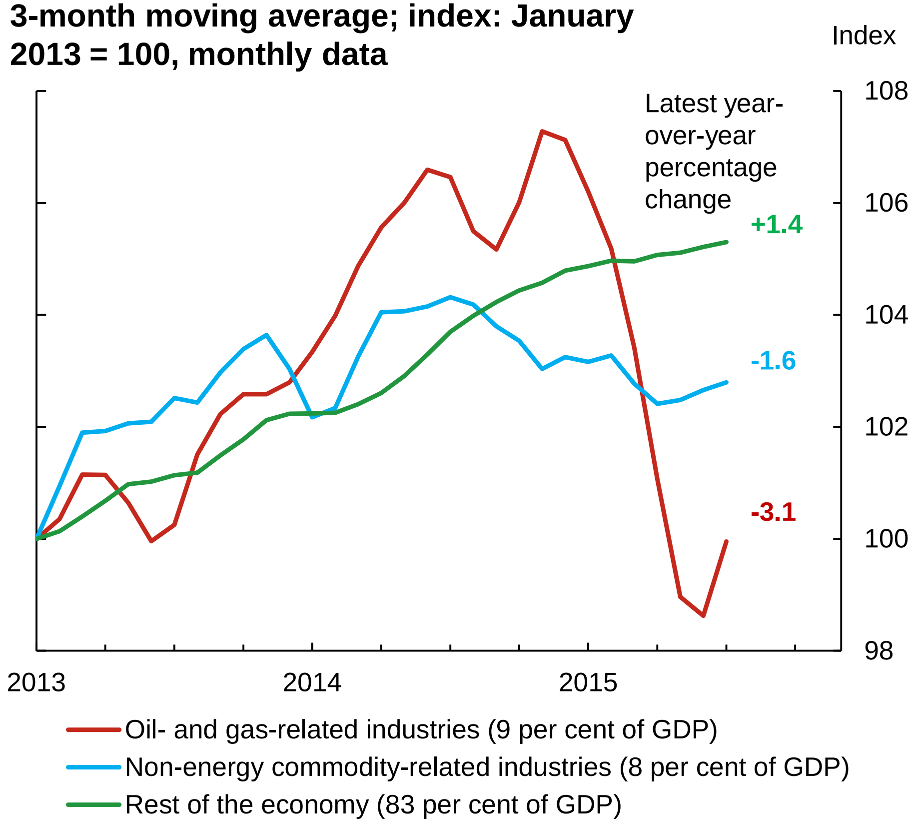
Highlights

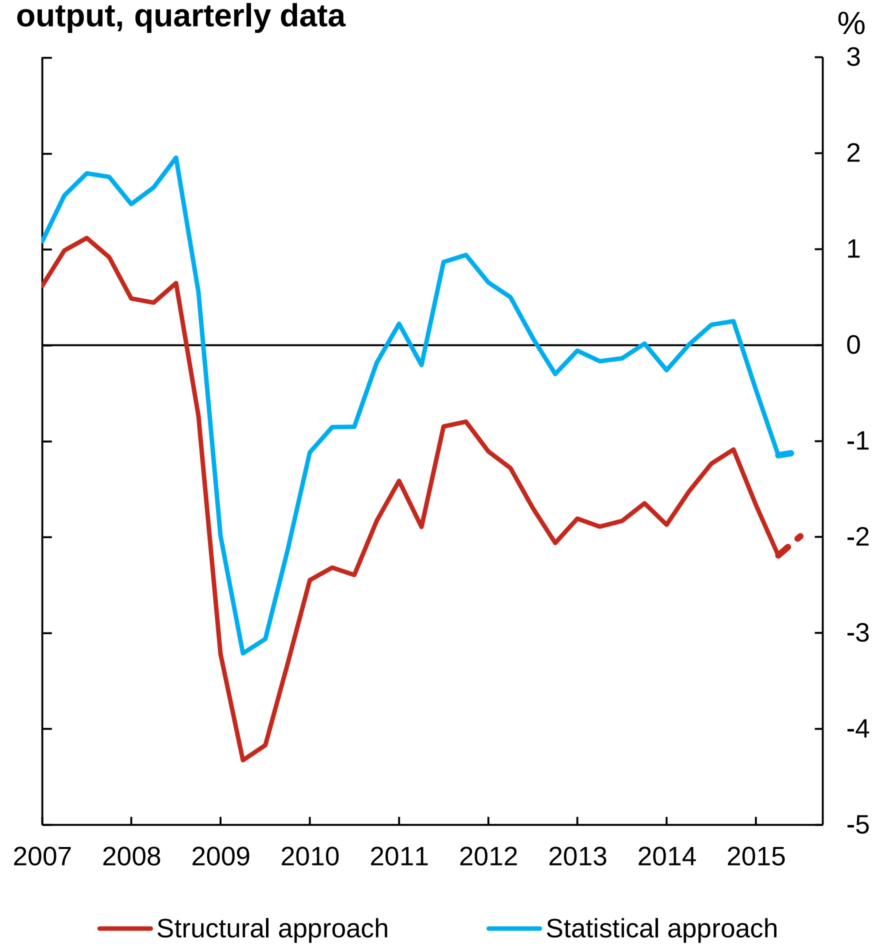
- Required reallocation across sectors and regions will take time to unfold
- Several factors facilitating adjustment
- Following modest contraction in first half of 2015, economy is rebounding
- Real GDP expected to increase by just over 1% this year, rising to 2% in 2016 and 2 ½% in 2017
- Excess capacity expected to be absorbed by mid-2017; at which time inflation should remain sustainably at 2 per cent

Weaker oil and other commodity prices, increased slack

3-month moving average; index: January 2013 = 100, monthly data



Per cent deviation of real GDP from potential output, quarterly data

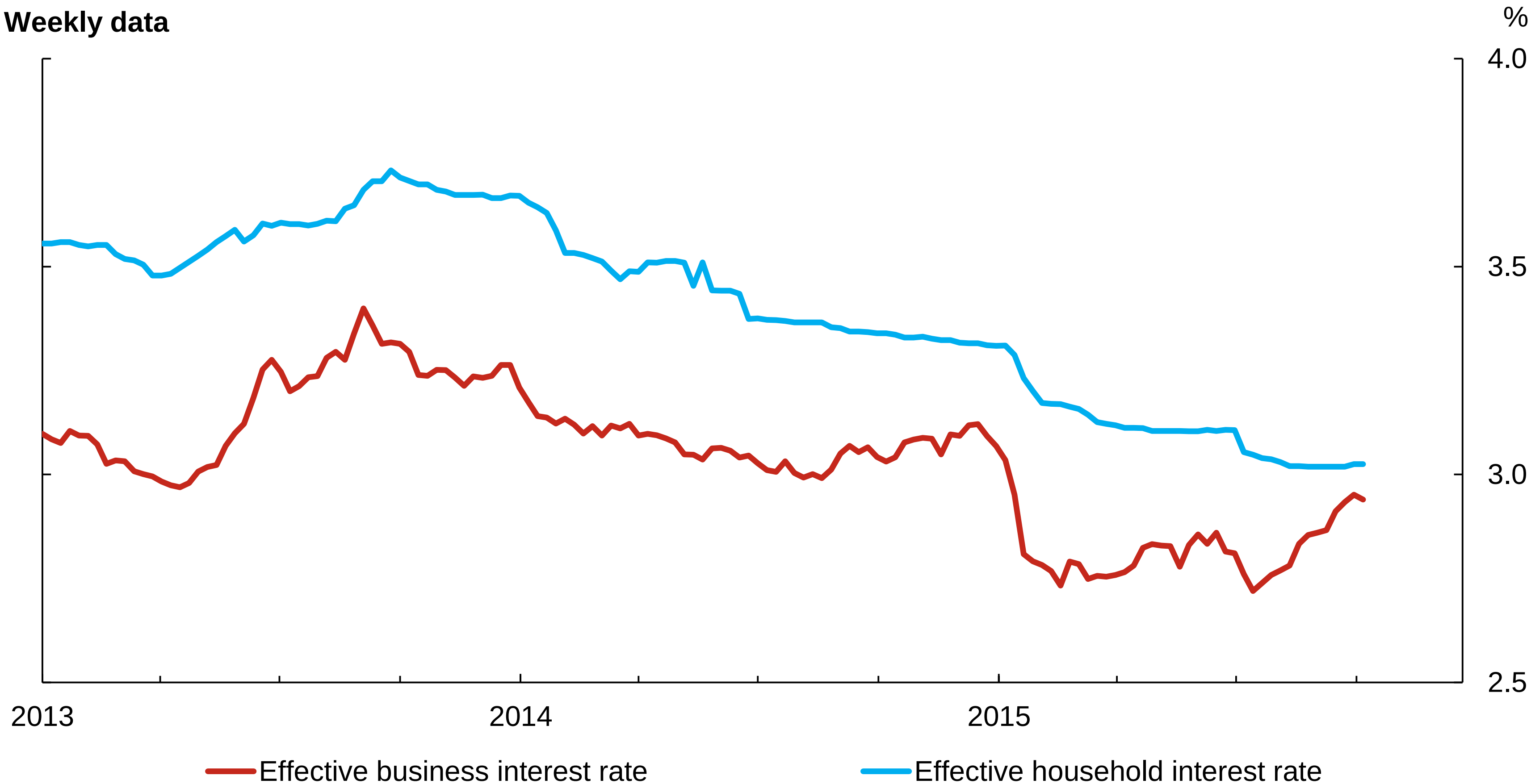


Note: The oil- and gas-related industries include extraction, support activities and engineering construction. The non-energy commodity industries include agriculture, forestry, fishing and hunting, mining and quarrying, wood product manufacturing, non-metallic mineral product manufacturing, primary metal manufacturing, fabricated metal product manufacturing, paper manufacturing, chemical manufacturing (excluding pharmaceuticals), and plastics and rubber products manufacturing. Pharmaceuticals, food and printing manufacturing are excluded from this calculation because of their consumer goods orientation.

Sources: Statistics Canada and Bank of Canada calculations

Last observation: July 2015

Household and business borrowing rates remain stimulative



Note: For more information on the series, see Statistics > Credit Conditions > Financial Conditions on the Bank of Canada's website.

Source: Bank of Canada

Last observation: 16 October 2015

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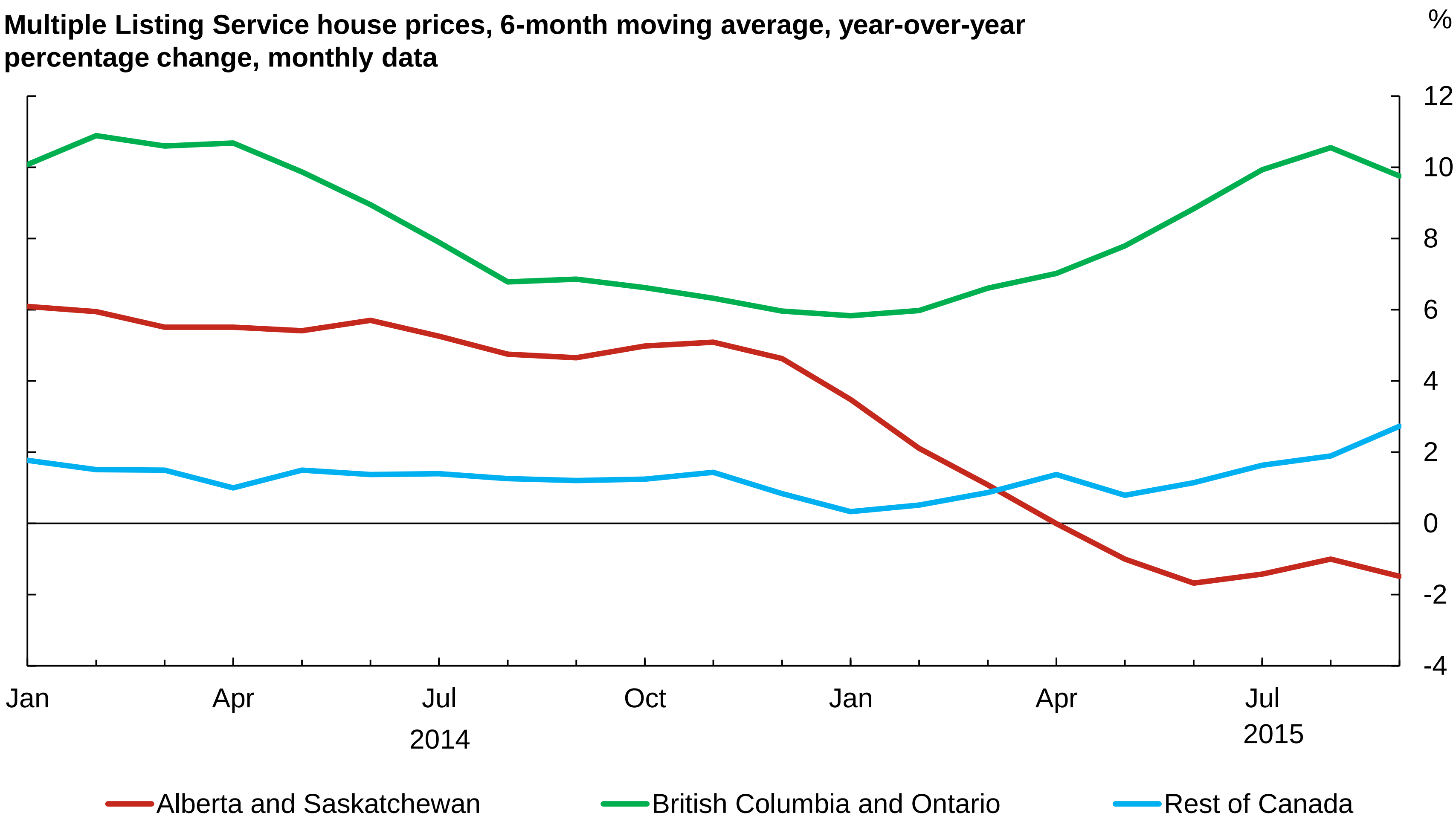
Housing markets continue to show different trends

Multiple Listing Service house prices, 6-month moving average, year-over-year percentage change, monthly data



Sources: Canadian Real Estate Association and Bank of Canada calculations

Last observation: September 2015

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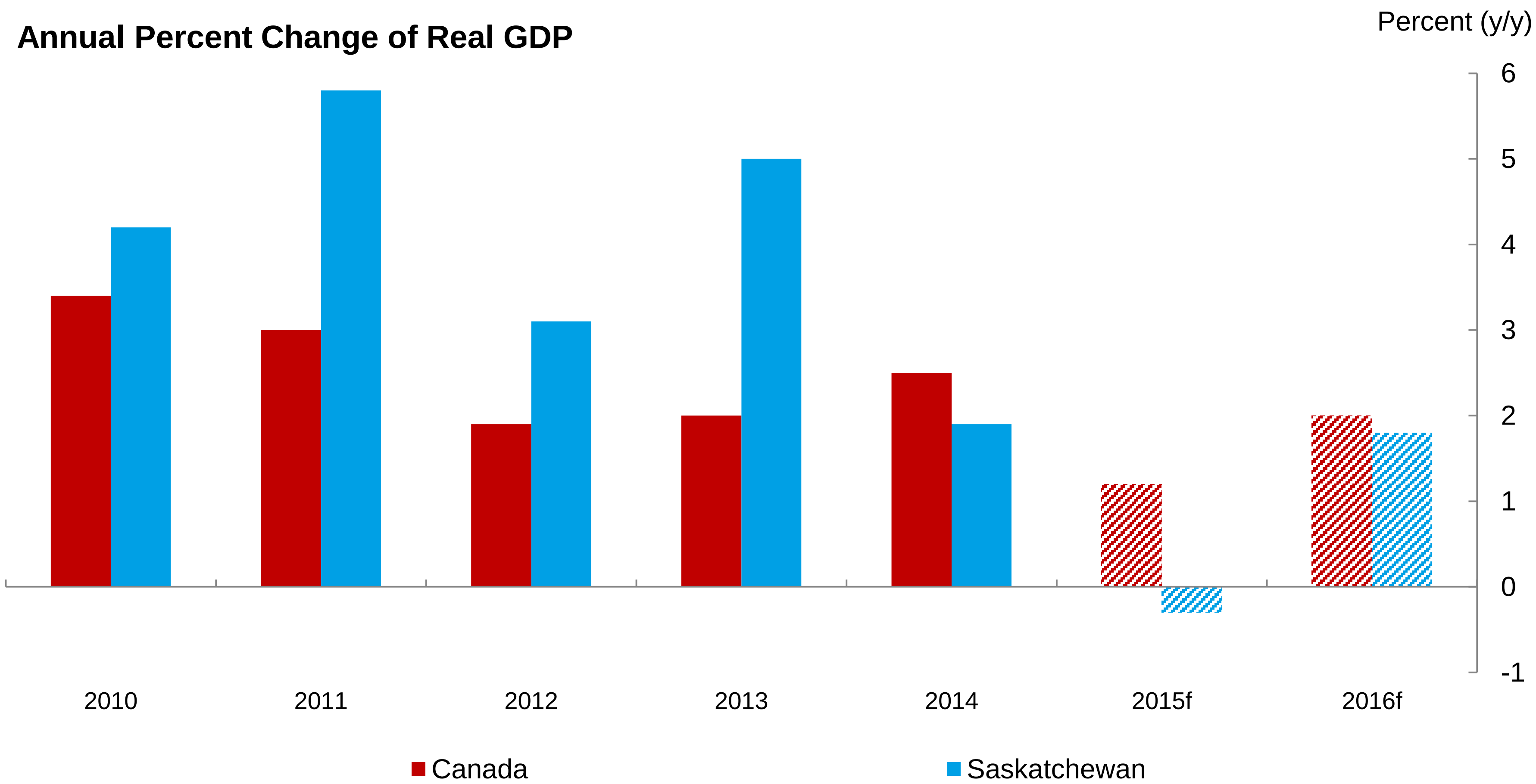
Regional divergences appearing

Change in economic indicators since November 2014				
		National	Energy intensive Regions[a]	Rest of Canada
Employment (Labour Force Survey)	% change	0.6	0.7	0.6
Unemployment rate[b]	p.p. change	0.4	2.0	0.0
Retail sales (nominal)[c]	% change	1.1	-2.8	2.1
Motor vehicle sales[d]	% change	1.3	-7.6	10.8
Housing resales[b]	% change	0.7	-22.1	5.9
Housing starts[b]	% change	20.5	-13.3	32.1

a Alberta, Saskatchewan, and Newfoundland and Labrador.
b. Last observation: October 2015
c. Last observation: August 2015
d. Last observation: September 2015

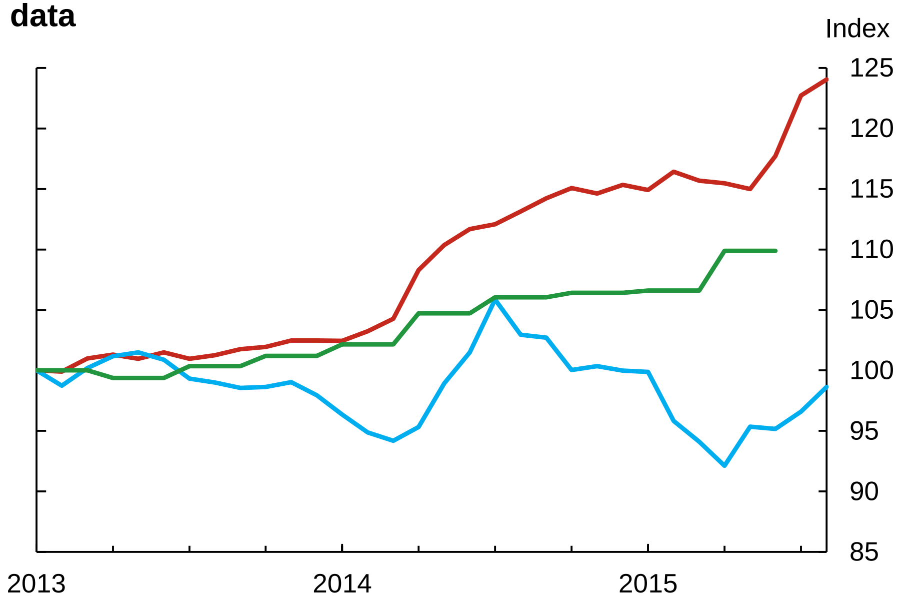
Private forecasters expect Saskatchewan's economic growth to remain below national GDP growth in 2015 and 2016



Source: Statistics Canada and Private Sector Forecasts

Current export profile

Non-commodity goods exports, 3-month moving average; index: January 2013 = 100, monthly data
Travel services exports; index 2013Q1 = 100, quarterly data

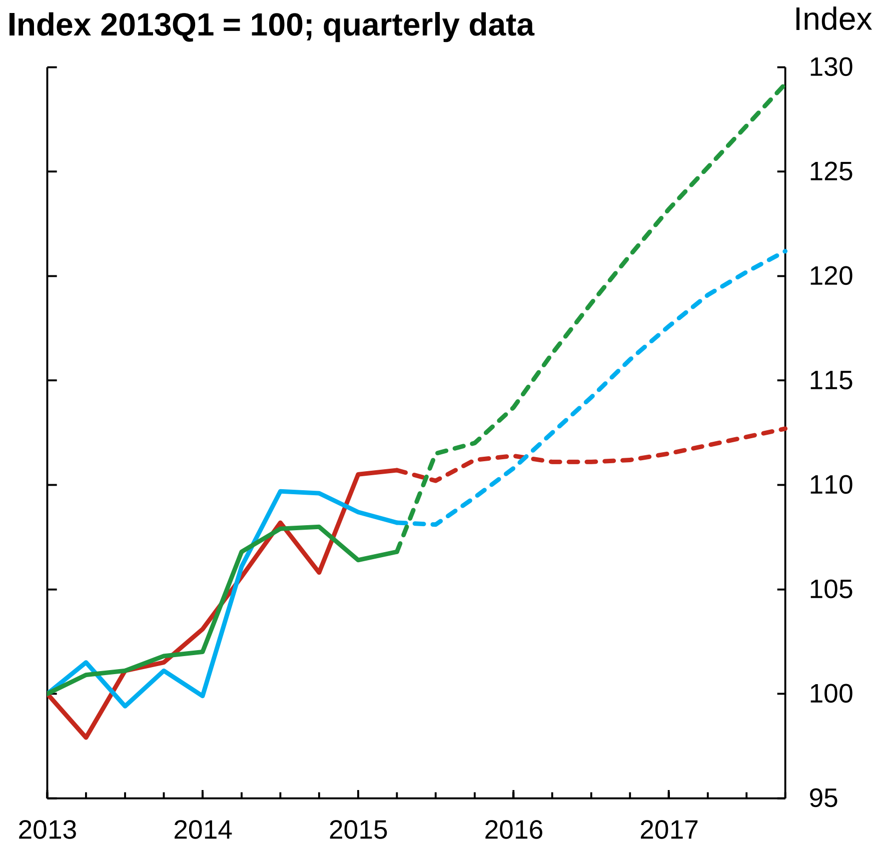


Non-commodity goods more sensitive to exchange rate (63 per cent of non-commodity goods exports)
Non-commodity goods less sensitive to exchange rate (37 per cent of non-commodity goods exports)
Travel services exports (20 per cent of total services exports)

Last observations: August 2015 for non-commodity goods exports and 2015Q2 for travel services exports

Sources: Statistics Canada and Bank of Canada calculations

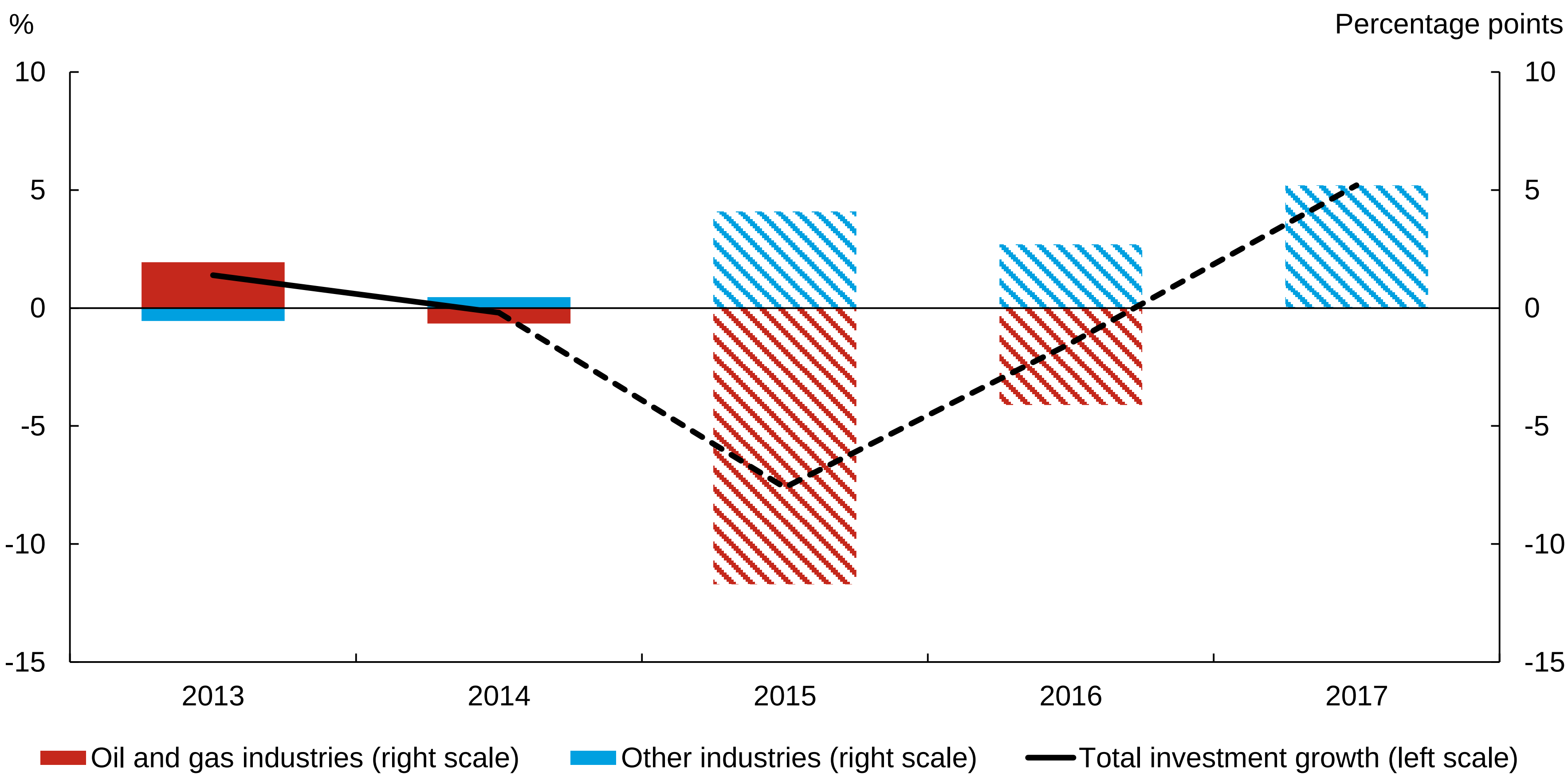
Index 2013Q1 = 100; quarterly data



Energy exports
Non-energy commodity exports
Non-commodity exports

Oil- and gas-related business investment is expected to remain negative in 2016

Contribution to total business investment growth, annual data

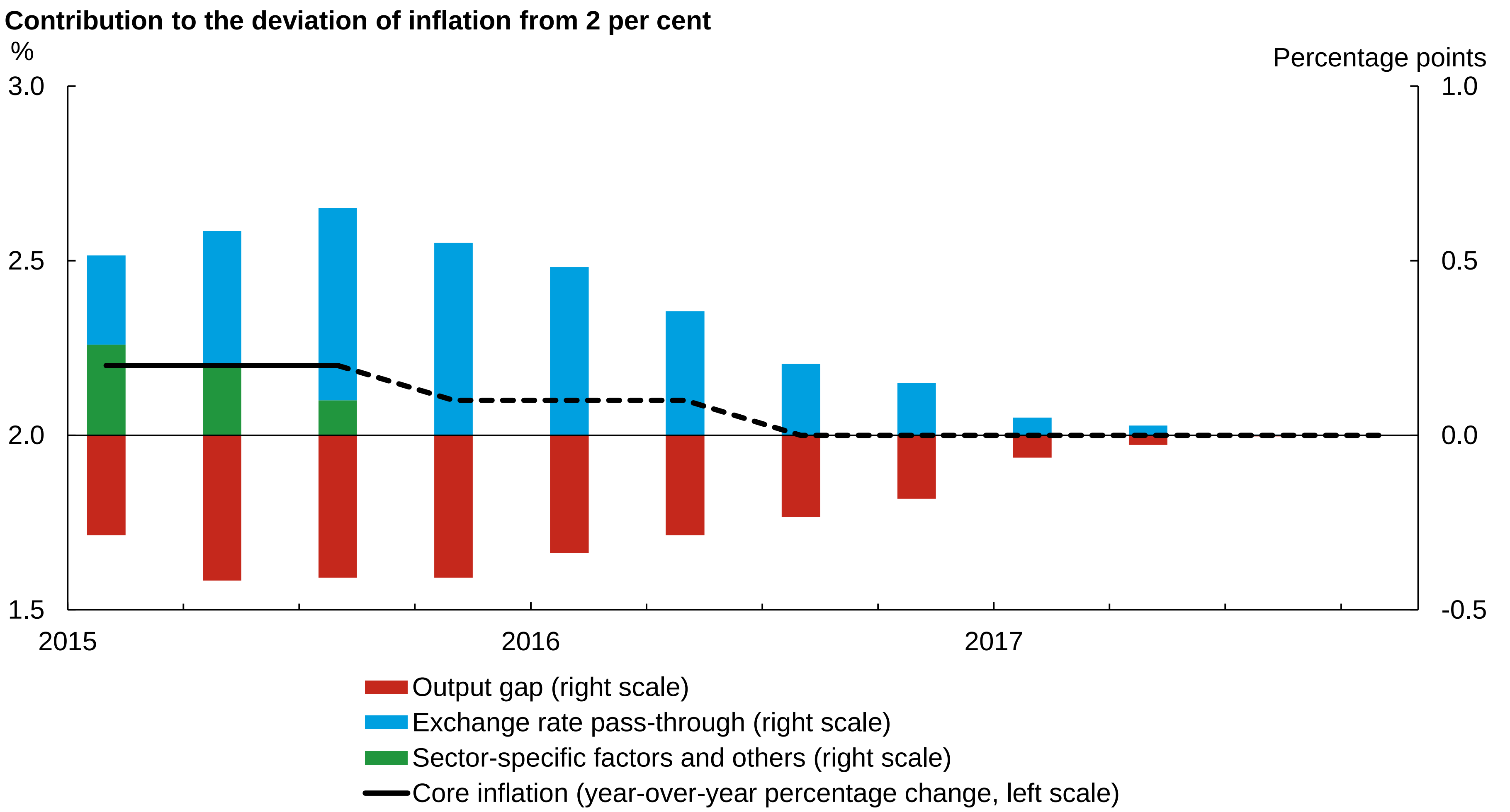


Projection

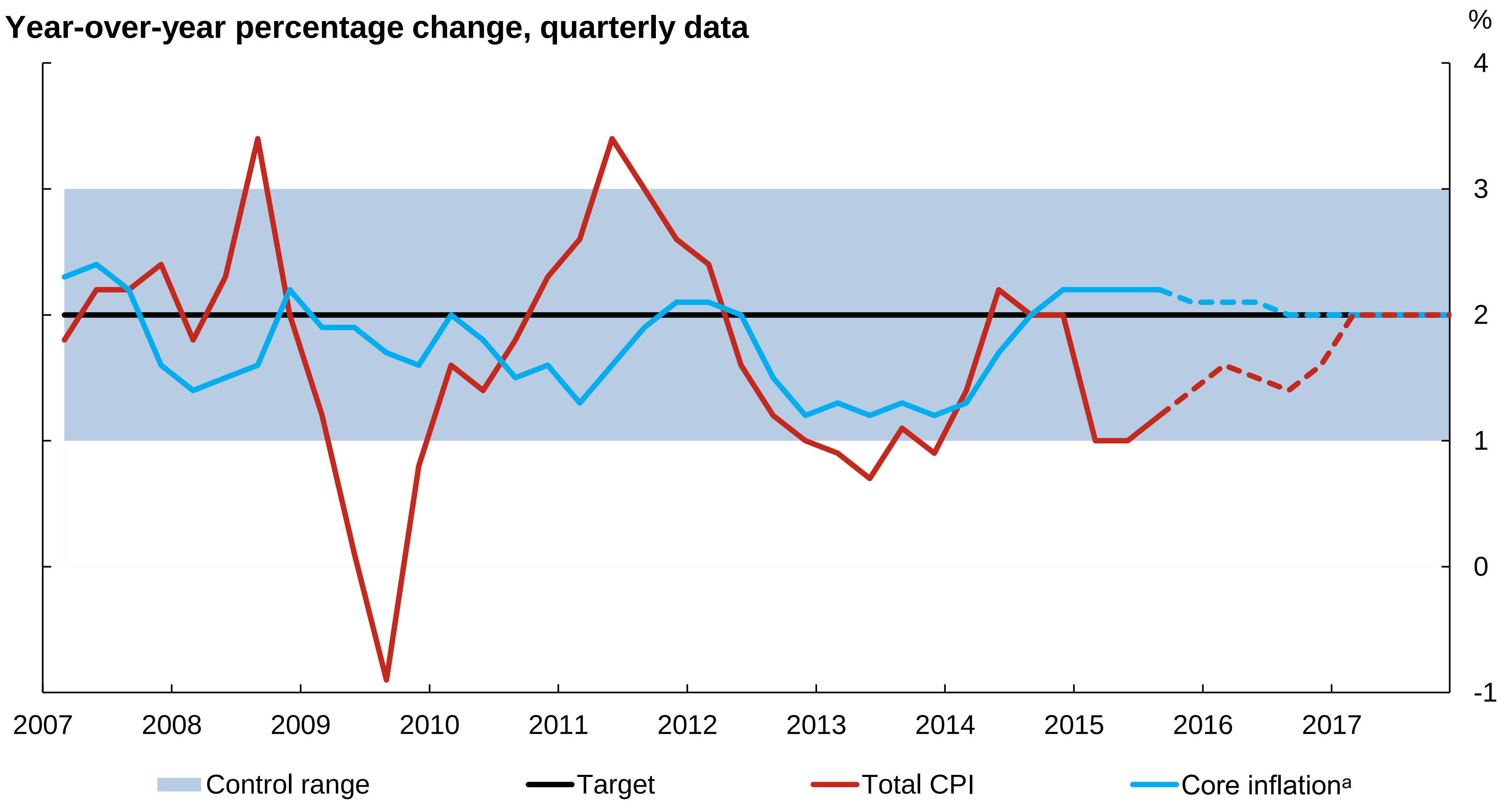
Contributions to average annual real GDP growth
Percentage points

	2015	2016	2017
Consumption	1.2	1.1	1.0
Housing	0.3	0.0	0.0
Government	0.2	0.1	0.2
Business fixed investment	-0.9	-0.2	0.7
Subtotal: final domestic demand	0.8	1.0	1.9
Exports	0.9	1.7	1.7
Imports	-0.3	-0.6	-1.1
Subtotal: Net exports	0.6	1.1	0.6
Inventories	-0.3	-0.1	0.0
GDP	**1.1**	**2.0**	**2.5**
Memo items: Range for potential output	1.6 -2.0	1.4-2.2	1.3-2.3
Real Gross Domestic Income (GDI)	-1.2	1.2	2.5

Core inflation measures remain near target



Inflation is expected to remain at 2 per cent



a. CPI excluding eight of the most volatile components and the effect of changes in indirect taxes on the remaining components

Most important risks to inflation outlook

- Weaker Canadian exports and investment
- Household sector imbalances
- Stronger U.S. private demand
- Higher non-energy commodity prices
- Financial Market Stress in EMEs

Thank you