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Opening Statement by Stephen S. Poloz
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Good morning, Mr. Chairman and committee members. Senior Deputy Governor Wilkins and I are happy to be back to discuss the Bank's *Monetary Policy Report* (MPR), which we published last week.

It has been 18 months since Carolyn and I were last here. And it was about that time, in the fall of 2014, when the Canadian economy first started to feel the effects of a massive shock to our terms of trade, brought about by a sharp drop in the price of oil and other commodities.

Because Canada is such an important producer of resources, particularly oil, this shock was a major setback. It set in motion a difficult adjustment process that has been very disruptive for many Canadians. Investment and output in resource industries have fallen precipitously, the decline in national income has curbed household spending and the resource sector has seen significant job losses. These negatives have clearly outweighed the benefits of lower energy costs for households and businesses.

From a monetary policy perspective, the shock posed a two-sided threat to our economy last year. First, it was a clear downside risk to our ability to reach our inflation target. Second, by cutting into national income, it worsened the vulnerability posed by household imbalances as seen in our elevated debt-to-income ratio. To address both threats and to help facilitate the necessary economic adjustments, we lowered our policy interest rate twice last year, bringing it to 0.5 per cent.

While we recognized the possibility that this reduction could, at the margin, exacerbate the vulnerability posed by household imbalances, the more important effect of lowering the policy rate last year was to cushion the drop in income and employment caused by lower resource prices.

Another natural consequence of the shock to our terms of trade has been a decline in the Canadian-dollar exchange rate. It's important to note that this is not unique to Canada. Indeed, many resource-reliant countries have seen similar depreciations in their currencies.

Both our policy moves and the lower currency have been helping to facilitate the economic adjustments, which have been playing out over two tracks. While weakness has been concentrated in the resource sector, the non-resource economy continues to grow at a moderate pace. And within that, non-resource exports are clearly gathering momentum.

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By the time we reached the new year, there was a clear sense of anxiety among many financial market participants. The outlook for global growth was being downgraded again, and commodity prices were plumbing new lows. At the Bank, we had new intelligence that Canadian energy companies would be cutting investment even more than previously thought. In this context, we said that we entered deliberations for our January interest rate decision with a bias to easing policy further, but decided to wait to see details of the government's fiscal plan.

Since January, we've seen a number of negative developments. First, projected global economic growth has once again been taken down a notch for 2016 and 2017. This includes the US economy, where the new profiles for investment and housing mean a mix of demand that is less favourable for Canadian exports.

Second, investment intentions in Canada's energy sector have been downgraded even further. True, oil prices have recovered significantly from their extreme lows. But Canadian companies have told us that even if prices remain around current levels, there will be significant further cuts beyond what we foresaw in January. By convention, we incorporate the average oil price from the few weeks before we make our forecast, letting us look through variability in markets. Because of this, our oil price assumptions are only $2 to $3 per barrel higher than they were in January.

Third, the Canadian dollar has also increased from its lows. Our assumption in our current projection is 76 cents US, four cents higher than in January. While there are many factors at play, including oil prices, most of the increase appears to be due to shifts in expectations about monetary policy in both the United States and Canada. The higher assumed level of the dollar in our projection contributes to a lower profile for non-resource exports, as does lower demand from the United States and elsewhere.

As the Bank's Governing Council began its deliberations for this month's interest rate announcement, we saw that these three developments would have meant a lower projected growth profile for the Canadian economy than we had in January. This may sound counterintuitive, given the range of monthly economic indicators that started the year strongly. However, some of this strength represents a catch-up after temporary weakness in some areas during the fourth quarter, and some of it reflects temporary factors that will unwind in the second quarter.

The other new factor we had to take into account was the federal budget. For the purposes of our MPR and interest rate announcement, we took a close look at the Finance Department's projections of the multiplier effect of the fiscal shock. Our analysis is that the Department's projections are reasonable in that they are within the range of estimates you would find in the economic literature, as well as in our own staff research. There is, of course, greater uncertainty as to how the budget measures will affect growth in the longer term, particularly since they will need to work their way through the household sector. In our report, we outlined the risk that households may be more inclined to save than historical experience would suggest.

Taking all of these changes on board, our projected growth profile is generally higher than it was in January. We are now projecting real GDP growth of 1.7 per cent this year, 2.3 per cent next year and 2 per cent in 2018. Our forecast

suggests that the economy will likely use up its excess capacity somewhat earlier than we predicted in January—sometime in the second half of 2017. However, there is more than the usual degree of uncertainty around that timing. It is always tricky to estimate an economy's potential output, and the difficulty is compounded when the economy is going through a major structural adjustment, as Canada is right now. We know that the collapse in investment in the commodity sector will mean a slowdown in the economy's potential growth rate. In the near term, we've lowered our estimate of potential output growth from 1.8 per cent to 1.5 per cent.

In terms of the Bank's primary mandate, total CPI inflation is currently below our 2 per cent target. The upward pressure on imported prices coming from the currency depreciation is being more than offset by the impact of lower consumer energy prices and the downward pressure coming from excess capacity in the economy. As these factors diminish, total inflation is projected to converge with core inflation and be sustainably on target sometime in the second half of next year.

To sum up where we are, while recent economic data have been encouraging on balance, they've also been quite variable. The global economy retains the capacity to disappoint further, the complex adjustment to lower terms of trade will restrain Canada's growth over much of our forecast horizon, and households' reactions to the government's fiscal measures will bear close monitoring. We have not yet seen concrete evidence of higher investment and strong firm creation. These are some of the ingredients needed for a return to natural, self-sustaining growth with inflation sustainably on target.

With that Mr. Chairman, Carolyn and I would be happy to answer questions.