Opening Statement by Stephen S. Poloz
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Appearance Before the House of Commons
Standing Committee on Finance
October 31, 2017
Ottawa, Ontario

Good afternoon, Mr. Chairman and committee members. Senior Deputy Governor Wilkins and I are happy to be before you today to discuss the Bank's *Monetary Policy Report* (MPR), which we published last week.

When we were last here in April, we were celebrating the fact that we had upgraded our economic forecast following a long period of disappointment. I am happy to tell you that many of the positive trends that we saw then have continued. Sources of economic growth have broadened across sectors and regions, and the process of adjustment to the oil price shock is essentially complete.

The Bank raised its policy interest rate twice since our last visit, in July and September. We did this in the context of very strong economic growth over the first half of the year and solid progress in the labour market. Over the summer, we saw evidence of firming inflation and an economy that was rapidly closing its output gap. With these two rate increases, we have taken back the cuts we made in 2015, which were crucial in helping the economy adjust to the oil shock.

Growth in the first half of the year averaged just over 4 per cent at an annual rate. This reflected strong consumer spending backed by rising employment and income, together with increased business investment and a jump in energy exports. We are now starting to see signs of moderation in the second half, which we forecast in July. Growth in consumption and investment is expected to ease, and growth in housing is projected to slow further, in part because of the measures introduced by the Ontario government in April.

All told, we forecast that the economy will expand by 3.1 per cent this year, before slowing to 2.1 per cent in 2018. This is still faster than the growth rate of potential. We estimate that the economy is now operating close to its capacity. Inflation should reach our 2 per cent target in the second half of next year, a little later than earlier projected because of the temporary impact of the stronger Canadian dollar this year.

We are at a crucial spot in the economic cycle, and significant uncertainties are clouding the way forward. In our MPR, we identified the four most important sources of uncertainty. I will touch on these now.

The first issue is inflation itself. There have been several conjectures about the apparent softness of inflation in Canada and many other advanced economies. Some have argued that globalization is restraining inflation. This could be due to increased imports from lower-cost countries, for example, or the effect of

Not for publication before October 31, 2017
15:30 Eastern Time

Canadian companies participating in global supply chains. Others point to the impact of digitalization on the economy. They suggest that digital technologies could lower barriers to entry in some sectors and lead to more competition. The rise of e-commerce may be changing price-setting behaviour. And digital technologies could promote innovation and higher productivity, which could create disinflationary pressure.

The second issue is the degree of excess capacity in the economy. We note several signs that point to slack remaining in the labour market. For example, the participation rate of young workers is still below trend, and average hours worked are less than we would expect. With the economy now operating close to capacity, we expect to see investment by companies, together with job creation by new and existing firms, and rising productivity. This should serve to raise the economy's potential output, increasing the amount of non-inflationary growth that is possible. However, this process is highly uncertain and not at all mechanical, so we have built it into our projection in a conservative way.

The third issue is the continued softness in wage growth. While employment growth has been strong in Canada, wages have not kept pace. The slack in the labour market is certainly responsible, in part, for this effect, and there will be a lag between the time this slack is used up and when we see stronger wage growth. However, other factors, including globalization, may also be affecting wage dynamics.

Finally, the fourth issue is the elevated level of household debt and how that might affect the sensitivity of the economy to higher interest rates. Bank staff have recalibrated our main economic model used for projections to capture key information about housing and debt. This work tells us that the economy is likely to respond to higher interest rates more than it did in the past. However, we will watch incoming economic data closely for evidence to support this idea. We will also look to see how the household sector is responding to the new rules about mortgage underwriting.

We also outline several other risks in the MPR. Taken together, these give us a balanced outlook for inflation. We have not incorporated into our projection the risk of a significant shift toward more-protectionist trade policies in the United States, given the range of potential outcomes and the uncertainty about timing. However, we acknowledge that uncertainty about future US trade policy is having some impact on business confidence and investment spending, and this impact is reflected in our outlook.

In this context, Governing Council judged that the current stance of monetary policy is appropriate. We agreed that the economy is likely to require less monetary stimulus over time, but we will be cautious in making future adjustments to our policy rate. In particular, the Bank will be guided by incoming data to assess the sensitivity of the economy to interest rates, the evolution of economic capacity, and the dynamics of both wage growth and inflation.

With that, Mr. Chairman, Senior Deputy Governor Wilkins and I would be happy to answer questions.