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Bank of Canada policy helps manage risks from debt, Governor Poloz says

YELLOWKNIFE, NORTHWEST TERRITORIES—Elevated household debts make the Canadian economy more vulnerable to events that could affect growth and financial stability, and the Bank of Canada's cautious approach to monetary policy is helping manage the risks, Governor Stephen S. Poloz said today.

In a speech to the Yellowknife Chamber of Commerce, Governor Poloz said that high household debt levels are likely to persist for years and will continue to make the economy more sensitive to changes in interest rates than it was in the past. This issue is particularly important for the Bank now because the economy is operating near the limits of its capacity, he added, so higher interest rates will be needed over time to keep inflation on target.

"The economic progress we have seen makes us more confident that higher interest rates will be warranted over time, although some monetary policy accommodation will still be needed," Governor Poloz said. "We will continue to watch how households and the entire economy are reacting to higher interest rates. And we will be cautious in making future adjustments to monetary policy, guided by incoming data."

Canadian households have built up about $2 trillion of debt, including $1.5 trillion of mortgage debt. This debt stock is the natural consequence of a number of factors, including consistent strong demand for houses and a prolonged period of low interest rates that allowed borrowers to take out larger mortgages for the same payment size.

This debt is now a vulnerability, both for the whole economy and for highly indebted households who will face increased debt-service costs when interest rates rise. "We are closely watching the vulnerability represented by this group and the debt they carry, and how it poses a risk to both the financial system and the economy," Governor Poloz said.

The Governor said that macroprudential policies—such as new mortgage regulations—are a welcome addition. Such policies "are helping reduce the economy's vulnerability, since new borrowers will be more resilient than existing borrowers," he said.

Household debt "poses risks to the economy and financial stability, and its sheer size means that its risks will be with us for some time. But there is good reason to think that we can continue to manage these risks successfully," Governor Poloz concluded.