BANK OF CANADA
BANQUE DU CANADA

Opening Statement by Stephen S. Poloz
Governor of the Bank of Canada
Appearance before the House of Commons
Standing Committee on Finance
October 30, 2018
Ottawa, Ontario

Good afternoon, Mr. Chairman and committee members. Senior Deputy Governor Wilkins and I are pleased to be with you today to discuss the Bank's *Monetary Policy Report*.

At the time of our last appearance in April, our message was about the considerable economic progress that we had seen. We explained that after a lacklustre start to 2018, growth would rebound in the second quarter, coming in at around a 2 per cent pace for the rest of the year. We also said inflation would stay somewhat above our 2 per cent target this year, boosted by temporary factors whose impact would unwind over time, returning inflation to target in 2019.

Six months later, we have seen some very positive developments. The Canadian economy has solid momentum and continues to operate near its capacity. Growth is relatively broad-based across sectors and regions and it is more balanced, as the composition of demand shifts toward business investment and exports and away from consumption and housing. The economy will grow at a rate slightly above its potential over the projection horizon, supported by both foreign and domestic demand and favourable financial conditions. Meanwhile, inflation is close to target after running a little higher than we expected in July and August due in large part to changes in the way Statistics Canada measures airfares. While there could be further volatility in inflation in coming months, our core measures remain firmly around 2 per cent.

Of course, the outlook remains subject to important risks and uncertainties. Let me highlight two issues: trade and household indebtedness.

In April we said the most significant risk to our inflation outlook was the prospect of a large shift toward protectionist trade policies around the globe. We also reminded members that our forecast included the negative effect of increased uncertainty on the export and investment plans of companies. Naturally, we spent a considerable amount of time ahead of last week's interest rate decision discussing the implications of the recent US–Mexico–Canada trade agreement (USMCA). The USMCA is good news because it will reduce a considerable source of uncertainty that has been holding back business investment. We know from our latest business survey, completed before the agreement was reached, that investment plans were already quite positive, as firms looked to take advantage of a strong US economy. Given the agreement, we reversed some of the markdown of our investment outlook. To be prudent, we did not remove all of it, for two reasons. First, we want to see how firms actually adjust their investment plans. Second, we know that competitiveness challenges are also weighing on investment.

Not for publication before October 30, 2018
15:30 Eastern Time

Protectionist trade actions, particularly those involving the United States and China, were also top of mind for us, as they are already affecting the global outlook. We have incorporated in our forecast the expected effects of the tariffs imposed to date, as well as the dampening effects on confidence from threats of additional measures. All told, we estimate that this will amount to a drag on the global economy of 0.3 per cent by the end of 2020. That is a big cost—it adds up to more than US$200 billion.

The US–China trade issue represents a two-sided risk for Canadian monetary policy. The United States and China could find a path to ease or resolve this trade conflict, which would be positive for global trade and investment, and for Canada. Or, the conflict could worsen, jeopardizing key global value chains. This would surely reduce long-term growth and prosperity globally, albeit with uncertain implications for inflation. For more information on the potential impact of US–China trade tensions, I refer you to Box 1 in the MPR.

As for household indebtedness, we have also been assessing how people are adapting to both higher interest rates and the changes to the B-20 mortgage underwriting guidelines implemented earlier this year. Box 4 in the MPR goes into some detail on the impact of these policy changes on mortgage lending.

Overall, the data tell us that households are adjusting their budgets largely as expected. We understand that this can be difficult, particularly for those who are highly indebted. At the same time, employment and incomes continue to grow, which can help cushion the adjustment process. Further, the quality of new debt is improving and housing activity is moderating to a more sustainable level. All of this is making the economy more resilient and is reducing the chances of painful outcomes for many people further down the road. The rule changes also appear to have taken the wind out of the sails of speculators in some markets, reducing the pressure on housing affordability. While financial system vulnerabilities are still elevated, the fact that they have stabilized and edged down in a number of respects is positive.

Let me conclude by pointing out that, even with last week's increase in the policy rate to 1.75 per cent, monetary policy remains stimulative. In fact, the policy rate today is still negative in real terms, that is, once you adjust for inflation. Our estimate of neutral is in a range—currently 2 ½ to 3 ½ per cent. The policy rate will need to rise to neutral to achieve our inflation target. That said, the appropriate pace of increases will depend on our assessment at each fixed announcement date of how the outlook for inflation and related risks are evolving. In particular, we will continue to take into account how the economy is adjusting to higher interest rates, given the elevated level of household debt, and whether strong consumer confidence builds on solid job and income growth and leads to greater-than-expected consumption. We will also pay close attention to global trade policy developments and their implications for the inflation outlook. Again, this risk is two-sided.

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