BANK OF CANADA
BANQUE DU CANADA

Remarks by Tiff Macklem
Governor of the Bank of Canada
Appearance before the
Standing Senate Committee on
Banking, Trade and Commerce
June 16, 2021
Ottawa, Ontario

Good afternoon, Chair and committee members. This is my first opportunity to address this committee since being appointed Governor of the Bank of Canada, and I am very pleased to be here. We consider these appearances to be an important part of our accountability to Canadians, and I look forward to your questions and perspectives.

To begin, I'd like to review for the committee the Bank of Canada's actions since the start of the pandemic. I will also provide our assessment of the progress toward economic recovery.

Through the pandemic, the Bank of Canada has had two overarching goals. At the beginning of the crisis, our objective was to restore financial market functioning and keep credit flowing. As market functioning improved and Canadians began to come out of the first lockdown, our focus shifted to providing monetary policy stimulus to support the recovery, get Canadians back to work and bring inflation back to our 2 percent target.

Fifteen months ago, the extreme uncertainty caused by the virus and associated lockdowns triggered an unprecedented dash for cash in financial markets. With many more sellers of financial assets than buyers, credit markets froze, threatening access to credit for businesses and households. The Bank of Canada acted quickly and in scale, providing liquidity and purchasing assets to support the functioning of key Canadian financial markets. As a result, the Bank's balance sheet expanded rapidly as we purchased federal, provincial and corporate bonds, commercial paper, bankers' acceptances and mortgage bonds.

These new programs, 11 in all, were successful in restoring smooth functioning across financial markets. Today, all but one of our exceptional programs have been wound down or have ceased operations. The one remaining program is our purchases of Government of Canada bonds, also known as quantitative easing or QE, and I'll come back to this in a moment.

To provide monetary stimulus, the Bank lowered our policy interest rate as far as we effectively could, to 0.25 percent, in the spring of 2020. In the summer, we added exceptional forward guidance, committing to hold our policy rate at its effective lower bound until slack is absorbed so that we sustainably achieve our 2 percent inflation target. This commitment was supplemented and reinforced by our QE program, which is helping to lower interest rates across the yield curve, making it cheaper for households and businesses to borrow.

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In April 2021, the Bank published our revised outlook for the Canadian economy in the *Monetary Policy Report* (MPR), and economic developments since then have been broadly in line with that outlook. I would highlight three key messages.

First, the economic recovery is making good progress. Canadian households and businesses have shown impressive resilience to the pandemic, and with more Canadians getting vaccinated, we anticipate better times ahead.

Second, a complete recovery will still take some time. The third wave of the virus has been a setback. It has strained health care systems in some regions and has again hit sectors where physical distancing is difficult. Important parts of the economy remain very weak, and too many Canadians are still out of work.

Third, the Bank remains steadfast in its commitment to support Canadian households and businesses through the full length of the recovery. For working Canadians, a complete recovery means a healthy job market with good opportunities. And that includes low-wage workers, women and young people who have been hit hard by this pandemic. A complete recovery means companies have confidence that the pandemic is over and are investing to seize new business opportunities. And for both households and businesses, a complete recovery means they can count on inflation being sustainably at our 2 percent target. Let me elaborate on these themes.

Following a sharp bounce back in economic activity in the fall and winter, we've seen choppiness in growth again in the second quarter of 2021. Renewed lockdowns associated with the third wave of the pandemic dampened economic activity early in the quarter, largely as anticipated. The ebb and flow of the virus is mirrored by an ebb and flow of economic growth. Recent jobs data show that workers in contact-sensitive sectors remain most affected, and the employment rate remains well below its pre-pandemic level. Still, we have seen impressive resilience and adaptability from Canadian households and businesses. They have found new ways to shop, serve customers and work remotely.

Housing demand has been particularly strong, driven largely by the desire for more living space and by low mortgage rates. All the while, limited supply has led to a sharp increase in prices. As we explained in our May *Financial System Review*, it is important to understand that the recent rapid increases in home prices are not normal. Our analysis suggests that in some markets, price expectations have become extrapolative—meaning people may be rushing to buy partly because they expect prices to keep rising. This behaviour can exaggerate near-term house price increases relative to fundamental demand. There are also risks that some households may overstretch financially.

We welcome the revisions to the B-20 guideline issued by the Office of the Superintendent of Financial Institutions, which altered the minimum floor qualifying rate, as well as the parallel changes in the insured market. These changes should help protect Canadians from overstretching. The federal budget also included measures that will add supply. Overall, we expect the housing market to be better balanced, but we will continue to watch this area closely.

Looking more broadly at the economy as a whole, we forecast strong consumption-led growth in the second half of this year as vaccinations progress further and restrictions ease. Fiscal stimulus from the federal and provincial governments will also make an important contribution to growth. Strong foreign demand and higher commodity prices are expected to drive exports and business investment, leading to a more broad-based recovery. In our April MPR, we projected that the economy will grow by around 6½ percent this year, about 3¾ percent in 2022 and 3¼ percent in 2023.

With this improved outlook, we are hopeful that the pandemic will end up causing less labour market scarring and less lost capacity than we earlier feared. We have therefore revised up our estimate of the economy's potential output. But I want to emphasize that considerable uncertainty surrounds this estimate. As the recovery continues, we will be paying attention to a broad spectrum of indicators of slack, including a range of labour market measures.

Our monetary policy remains grounded in our inflation-targeting framework. The most recent data show that inflation remained above 3 percent in May. Inflation will likely remain near the top of our 1 to 3 percent inflation-control target range through the summer. This largely reflects base-year effects combined with much stronger gasoline prices. As these base-year effects fade, Governing Council expects the ongoing excess supply in the economy to pull inflation back down. In our most recent policy announcement last week, Governing Council judged that the economy still needs extraordinary monetary policy support. We remain committed to holding the policy interest rate at the effective lower bound until economic slack is absorbed so that the 2 percent inflation target is sustainably achieved. Based on our latest projection, this is expected to happen sometime in the second half of 2022, although this timing is unusually uncertain given the difficulties in assessing the economy's supply capacity.

Our forward guidance on our policy rate continues to be reinforced and supplemented by the Bank's QE program. In April, we adjusted our weekly purchases of Government of Canada bonds to a target of $3 billion, down from the previous minimum of $4 billion. This adjustment reflects the progress that we had already seen toward economic recovery.

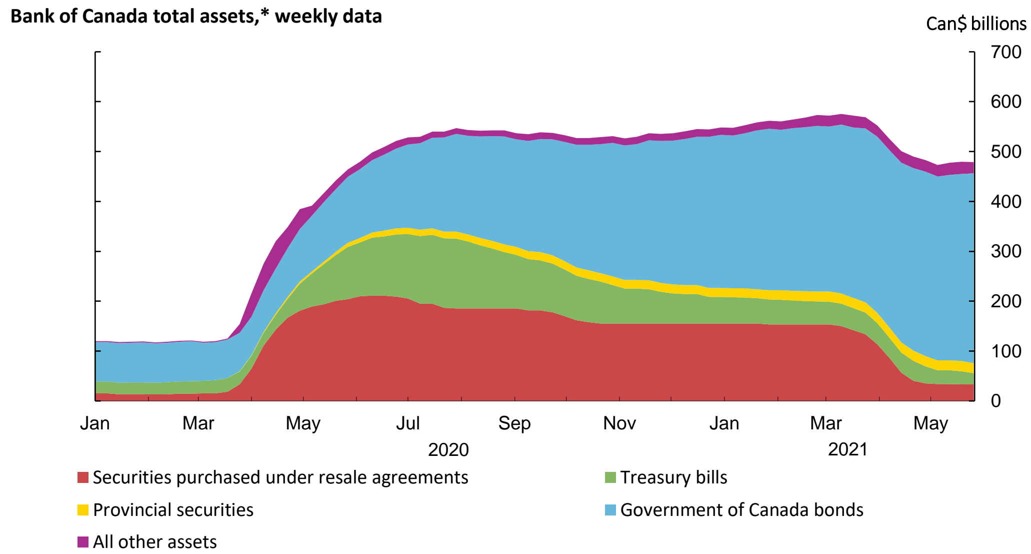
With the end of most of our extraordinary programs, the Bank's balance sheet has shrunk to about $475 billion from a peak of about $575 billion back in March. Below you will see a chart that shows the evolution of the size and composition of our balance sheet. The Bank currently holds more than $350 billion of Government of Canada bonds, representing about 45 percent of the outstanding stock of nominal bonds.

Looking ahead, further adjustments to the pace of net purchases will be guided by our ongoing assessment of the strength and durability of the economic recovery. If the recovery evolves in line with or stronger than our latest projection, the economy won't need as much QE stimulus over time. Further adjustments to our QE program will be gradual, and we will be deliberate in both our assessment of incoming data and the communication of our analysis.

We remain committed to providing the appropriate degree of monetary policy stimulus to support the recovery and achieve the inflation objective.

With that, let me stop and turn to you for questions.

Chart: The Bank's total assets have shifted in composition



* Government of Canada (GoC) bonds purchased in primary markets are measured at amortized cost. All other bonds, including GoC bonds purchased in secondary markets, are measured at fair value. "All other assets" includes provincial treasury bills and bonds, corporate bonds and commercial paper. A full list of assets can be found on the Bank of Canada's website.

Source: Bank of Canada

Last observation: May 31, 2021