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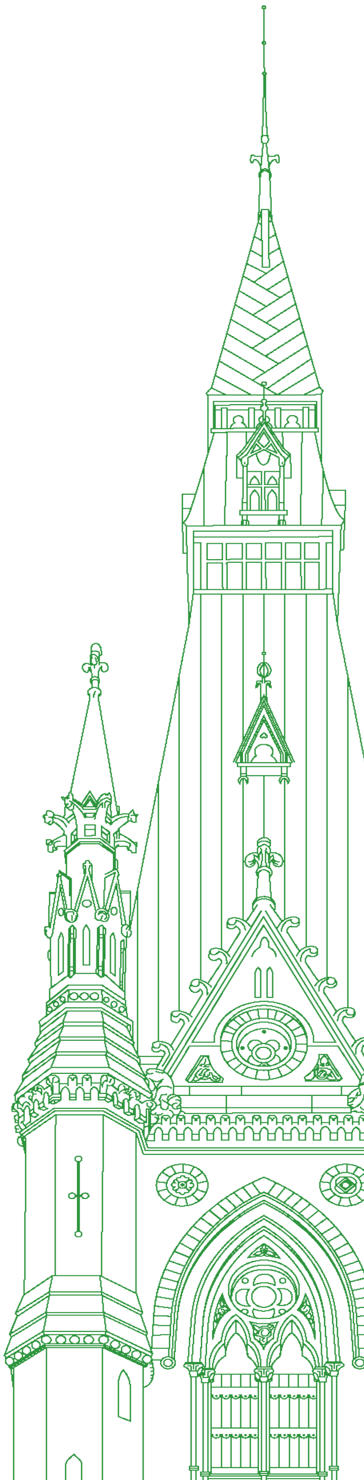

Chair: Mr. Peter Fonseca

Standing Committee on Finance

Monday, April 25, 2022

● (1100)

[*English*]

The Chair (Mr. Peter Fonseca (Mississauga East—Cooksville, Lib.)): I call this meeting to order.

Welcome to meeting number 38 of the House of Commons Standing Committee on Finance. Pursuant to Standing Order 108(2), the committee is meeting on the report of the Bank of Canada on monetary policy.

Today's meeting is taking place in a hybrid format pursuant to the House order of November 25, 2021. Members are attending in person in the room and remotely, using the Zoom application. Per the directive of the Board of Internal Economy on March 10, 2022, all those attending the meeting in person must wear a mask, except for members who are in their place during proceedings.

I'd like to make a few comments for the benefit of witnesses and members.

Please wait until I recognize you by name before speaking. For those participating by video conference, click on the microphone icon to activate your mike and please mute yourself when you are not speaking.

For interpretation for those on Zoom, you have the choice at the bottom of your screen of floor, English or French. For those in the room, you can use the earpiece and select the desired channel.

I remind you that all comments should be addressed through the chair.

For members in the room, if you wish to speak, please raise your hand. For members on Zoom, please use the “raise hand” function. With regard to a speaking list, the committee clerk and I will do the best we can to maintain a consolidated order of speaking for all members, whether they are participating virtually or in person, and we appreciate your patience and understanding in this regard. That being said, I request that members and witnesses treat each other with respect and decorum.

Before we begin, I'd like to remind our members, as discussed during the last meeting on the Emergencies Act draft report, to please submit any final comments or suggestions in both languages to the clerk as soon as possible.

It's my pleasure to be able to welcome our witnesses today. I say “welcome back” to the Governor of the Bank of Canada, Tiff Macklem. Joining Tiff is his senior deputy governor, Carolyn Rogers.

Welcome. The floor is yours.

Mr. Tiff Macklem (Governor, Bank of Canada): Thank you, Chair.

Good morning.

Let me say how pleased senior deputy governor Carolyn Rogers and I are to be here in person to discuss our monetary policy report and our decision of a couple of weeks ago.

We published our monetary policy report as Russia's unprovoked invasion of Ukraine entered its eighth week. The war is causing tremendous human suffering and our hearts go out to the Ukrainian people. The war has also injected new uncertainty into the global economic outlook. It is boosting already high inflation in many countries, including Canada, and it's disrupting the global economic recovery.

Against this backdrop, we have three main messages. First, the Canadian economy is strong. Overall, the economy has fully recovered from the pandemic and is now moving into excess demand. Second, inflation is too high. It is higher than we expected, and it's going to be elevated for longer than we previously thought. Third, we need higher interest rates.

Our policy interest rate is our primary tool to keep the economy in balance and bring inflation back to the 2% target. Two weeks ago we raised our policy rate by 50 basis points to 1%, and we indicated that Canadians should expect further increases.

Let me expand on each of these three themes.

[*Translation*]

Canadians have been through a lot in the past two years. Everyone has been touched by the pandemic, through illness or the loss of loved ones, fear and uncertainty, job loss or business closure. We experienced the sharpest and deepest recession on record, and repeated waves of the virus have made the recovery bumpy.

Thanks to exceptional monetary and fiscal stimulus, effective vaccines and a willingness to adapt and innovate, the economy has bounced back remarkably quickly. It has been the fastest and sharpest recovery ever, and now demand is beginning to run ahead of the economy's productive capacity.

● (1105)

[*English*]

The labour market shows this clearly. Before the pandemic, the unemployment rate was 5.7%. When the pandemic hit, it quickly soared to 13.4%, and now, two years later, it is at a record low of 5.3%. Job vacancies are elevated and wage growth has reached prepandemic levels. Businesses can’t find enough workers to meet demand, and they're telling us they’ll need to raise wages to attract and retain workers.

We expect strong growth to continue in the months ahead. As remaining public health restrictions ease, Canadians are spending more on services—travel and recreation, lodging and restaurants—and they're still buying a lot of goods. Housing activity is still strong, and while we expect it to moderate, it will remain elevated.

Business investment and exports are both picking up, and higher prices for many of the commodities Canada exports are bringing more income into the country. Robust business investment, improved labour productivity and higher immigration should help boost the economy’s productive capacity, and higher interest rates will slow spending.

Putting all this together, the bank forecasts that the Canadian economy will grow 4¼% this year, before moderating to 3¼% in 2023 and 2¼% in 2024.

That brings me to my second point.

The bank’s primary focus is inflation. The CPI inflation in Canada hit a three-decade high of 6.7% in March, well above what we projected in the January monetary policy report. The war has driven up the prices of energy and other commodities and is further disrupting global supply chains. While most of the factors pushing up inflation come from beyond our borders, with the economy in excess demand, we are facing domestic price pressures too. About two-thirds of CPI components are growing above 3%, which means that Canadians are feeling inflation across their household budgets, from gas to groceries to rent.

Our latest outlook is for inflation to average almost 6% in the first half of 2022 and remain well above our 1% to 3% control range throughout the year. We then expect it to ease to about 2½% in the second half of 2023 before returning to the 2% target in 2024.

High inflation affects everyone. Inflation at 5% for a year—or three percentage points above our target—costs the average Canadian an additional $2,000 a year, and it's affecting the more vulnerable members of society the most, because they spend all their income and because prices of essential items like food and energy have risen sharply.

[*Translation*]

This broadening in price pressures is a big concern. It makes it more difficult for Canadians to avoid inflation, no matter how patient or prudent they are as shoppers.

This brings me to my third point—interest rates are increasing. The economy needs higher rates and can handle them. With demand starting to run ahead of the economy's capacity, we need higher rates to bring the economy into balance and cool domestic inflation.

We also need higher interest rates to keep Canadians' expectations of inflation anchored on the target. We can't control or even influence the prices of most internationally traded goods. But if Canadians' expectations of inflation stay anchored on the 2% target, inflation in Canada will come back down when global inflationary pressures from higher oil prices and clogged supply chains abate.

[*English*]

We are committed to using our policy interest rate to return inflation to target, and we will do so forcefully if needed.

Increases in the bank’s policy rate raise the interest rates on business loans, consumer loans and mortgage loans, and they increase the return on savings. We have been clear that Canadians should expect a rising path for interest rates, but seeing their mortgage payments and other borrowing costs increase can be worrying. We will be assessing the impacts of higher rates on the economy carefully.

We recognize that everyone wants to know where rates might end up. How high are they going to go? It's important to remember that we have an inflation target, not an interest rate target. This means that we don't have a preset destination for the policy interest rate, but what I can say is that Canadians should expect interest rates to continue to rise towards more normal settings. By “more normal”, we mean within the range we consider for a neutral rate of interest that neither stimulates nor weighs on the economy. We estimate this to be between 2% and 3%. Two weeks ago, we raised the policy rate to 1%, still well below neutral. This is also below the prepandemic policy rate of 1.75%.

● (1110)

[*Translation*]

How high rates go will depend on how the economy responds and how the outlook for inflation evolves. The economy has entered excess demand with considerable momentum and high inflation, and we are committed to getting inflation back to target.

If demand responds quickly to higher rates and inflationary pressures moderate, it may be appropriate to pause our tightening once we get closer to the neutral rate and then take stock. On the other hand, we may need to take rates modestly above neutral for a period to bring demand and supply back into balance and inflation back to target.

[*English*]

Finally, let me a say a word on our balance sheet. As of this week, we are no longer replacing maturing Government of Canada bonds with new ones, so our balance sheet will shrink. This brings our exceptional monetary policy response full circle.

When the economy needed exceptional support in the depth of the recession, we lowered our policy rate to its lower bound and complemented this with quantitative easing, QE. Last November we ended QE and began reinvestment.

We have now moved to quantitative tightening, QT. With the economy fully recovered, it's time to normalize our balance sheet. QT will complement increases in our policy rate by putting upward pressure on longer-term interest rates.

Mr. Chair, I will stop here.

Senior deputy governor Rogers and I will be very pleased to take your questions.

The Chair: Thank you, Governor, for your opening remarks. We appreciate your coming before our committee. Thank you for wearing the Ukrainian flag pin on your lapel. We all stand with Ukraine here.

We are now going to move into rounds of members' questions. The first round will be six minutes for each party. We are going to start with the Conservatives. We have MP Fast up for six minutes.

Hon. Ed Fast (Abbotsford, CPC): Thank you, Mr. Chair.

Thank you, Governor, and thank you Ms. Rogers for coming back time and time again to explain monetary policy to members of Parliament.

Governor, you would acknowledge that Canada presently has an affordability crisis. Is that correct?

Mr. Tiff Macklem: It's certainly a big challenge.

Hon. Ed Fast: All right.

Over the last year, you've used the term “transitory” to describe our current inflation crisis. Do you still consider our current inflationary pressures to be transitory, or do you have a different way of describing what those inflationary pressures are today?

Mr. Tiff Macklem: I think it's fair to say that “team transitory” has disbanded. As you've seen in our own forecasts, we have substantially revised up our outlook for inflation.

Inflation is, today, considerably higher than we thought in January it was going to be. The main reason for that is the unprovoked invasion of Ukraine by Russia, which has boosted commodity prices. It's also further disrupting global supply chains. The other issue at play is—as you're seeing in today's news—that COVID is still with us. China, right now, is going through new lockdowns. That's further disrupting supply chains.

All these factors mean that not only is inflation higher, but it's going to be higher for longer.

● (1115)

Hon. Ed Fast: But you're not going to be using—

Mr. Tiff Macklem: To put it a little more positively, it's going to take longer to come down, so, yes, Canadians are, unfortunately, living with higher inflation.

Hon. Ed Fast: So we will dispose of the term “transitory”. Is that correct?

Mr. Tiff Macklem: Yes.

Hon. Ed Fast: In the most recent year, the inflation rate on a year-to-year basis was 6.7%. Do you expect that rate to go up in the coming months?

Mr. Tiff Macklem: Whether 6.7% is the peak is a tough call. There's quite a lot of volatility in inflation. It could go a little higher or that could be the peak. I do think we're close to the peak. I think what's important is that we do think, as we get into the second half of the year, that these global supply chain issues will start to ease. We will see some decrease in inflation.

But I don't want to pretend that we have great line of sight to these supply chain issues. We do expect it to come down, and what it will underline is that, whether this is the peak or not, 6.7% is too high, and we are committed to using our tools—including, if need be, forcefully—to get inflation back down.

Hon. Ed Fast: I'm glad to hear you commit to that.

I would like to ask you specifically about the risk of Canada tipping back into a recession, should inflationary pressures persist. Some economists now believe it is more a question of when, rather than if, a recession is coming.

Is this something you and your officials are planning for, or at least studying?

Mr. Tiff Macklem: It's a very important question.

If you look at our own projection, which we laid out a couple of weeks ago in our monetary policy report, what you see is that growth is moderating. Growth needs to moderate to bring demand in line with the economy supply capacity. That moderating growth is pretty solid growth: 3¼% next year and 2¼% the year after. And if you look at most private sector forecasts, they're broadly similar. They have inflation declining, with growth continuing at a more moderate pace.

I do want to underline, though, that getting this soft landing is not going to be easy. There is a delicate balance here. There are some good reasons to believe we can continue to grow while bringing inflation down. The two most important ones are, first, much of the inflation we have now comes from beyond our borders. We've seen increases in commodity prices and global supply chain disruptions. If oil prices stop going up and begin coming down—even just stop going up—and these global supply chain pressures begin to abate, we should see some natural reduction in inflation, provided we keep inflation expectations well anchored.

Let me underline that last point, which is critical. If we don't keep inflation expectations well anchored, inflation will get stuck at a higher level. So we need to do that, and that is reflected in our actions.

The second reason why you can have growth with declining inflation is that demand is running the house. We can see this in the labour market, where we have a very high level of vacancies. We have very strong employment, but we have a lot of vacancies. If we can moderate demand, we can reduce those vacancies, maintain high levels of employment, bring the economy back into balance and bring inflation back on target.

Hon. Ed Fast: Because my time is short, I just have one last question.

Many economists are now publicly saying that the Bank of Canada was left behind the curve in its response to controlling inflation, and probably could have increased rates earlier. Would you have responded differently had you known that inflation was going to be at the rate it is today?

Mr. Tiff Macklem: We got a lot of things right. We got some things wrong, and we are responding. You saw that a couple of weeks ago, when we took the unusual step of raising the policy rate by 50 basis points to 1%. We signalled very clearly that Canadians should expect further increases. Looking ahead to our next decision, I expect we will consider taking another 50 basis-point step.

● (1120)

The Chair: Thank you, and thank you, MP Fast.

We are moving to the Liberals. MP Dzerowicz, you have six minutes.

Ms. Julie Dzerowicz (Davenport, Lib.): Thank you, Mr. Chair.

I want to say that it's nice to see both of you in person. Thank you for being here and thank you for your extraordinary service to our nation, particularly during these unprecedented times. I know the job is extra difficult.

I also really appreciate you acknowledging Russia's unprovoked invasion of Ukraine, and your compassion. As a Ukrainian-Canadian, I find it awful, every single day, to see what's happening there. I know many Canadians share that feeling.

My first question is on that note. I believe, last week, you were sanctioned by Russia alongside several prominent Canadians. What is your reaction?

Mr. Tiff Macklem: The unprovoked attack of Russia on Ukraine is imposing unimaginable human suffering on the Ukrainian people. It's also seriously disrupting the global economy.

I spent most of last week in Washington at IMF meetings, G7 meetings and G20 meetings. The war really weighed on those meetings in two dimensions. One, this is a shock on top of COVID—it's a shock on top of a shock. It is a catastrophic shock for the Ukrainian economy. It's affecting economies in Europe, but it's rippling around the world. Two, it's also weighing on the global order. We went to Washington to meet with the IMF, the G20, to foster economic co-operation, to manage risks, and Russia is sitting at the table. The very source of this massive disturbance, this unjustified war, is sitting at the table.

The fact that I was sanctioned is just a trivial, minor consequence of this.

Ms. Julie Dzerowicz: Thank you.

My next question is regarding the IMF. The IMF's World Economic Outlook forecast Canadian real GDP growth leading the pack of all G7 countries in 2022 and 2023, all the while maintaining the lowest net debt-to-GDP ratio. Can you discuss the factors contributing to Canada's strong GDP growth and the strength of our economic recovery?

Mr. Tiff Macklem: In the monetary policy report, we develop in some detail what we think the sources of growth are. Thanks to exceptional monetary and fiscal policies; thanks to very effective vaccines; and thanks fundamentally to the adaptability, the resilience and the innovation of Canadians and Canadian businesses we've had a remarkable recovery, the fastest on record.

But our economy is now moving into excess demand. We are more than fully recovered from the pandemic, and growth needs to moderate. If you look at the sources of growth going forward, you see that households' balance sheets are in good shape, they have record-low unemployment, wages are going up, households are in good financial health, and they're spending. They're particularly spending on many of the services that they couldn't buy through the pandemic.

Businesses are telling us they're reaching capacity limits. They're telling us that they have ambitious investment plans to add capacity so they can respond to that increase in demand. The U.S. economy is robust and it's also hitting its own capacity limits, so that is increasing the demand for our imports.

If you look at the economy, you see that the recovery has been very consumer-led, and we're starting to see some broadening with stronger investment and stronger exports.

Ms. Julie Dzerowicz: Thank you.

My next question is about wage growth and the impact on inflation.

Last week I was listening to a few economists, and they were talking about how they were worried that wage growth shouldn't be growing as fast as it should be, because it's going to have an increased impact on inflation. My opinion is that our wages are not growing as fast as inflation, and I would say that for too long many workers actually haven't received the wage increase that they've needed to. In fact, there are many industries that are actually behind in terms of wage growth.

Is that something you're worried about in terms of wage growth and the impact on inflation?

● (1125)

Mr. Tiff Macklem: I'll just put the facts on the table. Wage growth was quite weak through the pandemic. It has rebounded and now it's back to a prepandemic level, roughly 3%. There are a whole variety of different measures of wages and different ones will give you slightly different signals, but it's roughly 3%. We do expect wage growth to increase further. Certainly when you talk to companies they're telling us they're having a hard time attracting workers, they're losing workers. They are telling us they're going to have to increase wages further.

The way we look at wages is we look at wages relative to productivity. To put it bluntly, higher productivity pays for higher wages. In our own projection we think there are good reasons why productivity will pick up. Restrictions are being eased so it's easier to get things done. Companies are investing and that's bringing new capital, which means workers will have better equipment, better computers to work with. That should improve output per worker. We do have wage growth picking up and we also have productivity picking up, and as long that happens higher wages are not a source of inflation. If we were to see wages run substantially ahead of productivity growth it would become a concern that, in that situation, higher wage growth could start to become an independent source of inflation. We're not seeing that yet, but it is something we are watching.

Ms. Julie Dzerowicz: Thank you.

The Chair: Thank you, MP Dzerowicz.

Now we'll move to the Bloc with Madame Sinclair-Desgagné.

[*Translation*]

Ms. Nathalie Sinclair-Desgagné (Terrebonne, BQ): Thank you, Mr. Chair. It's nice to see you.

Thank you for being here, Mr. Macklem and Ms. Rogers.

I quite appreciated your opening statement. You painted a clear picture of the current challenges and causes of inflation, among other things. You mentioned supply chain issues, which we've heard a lot about, as well as other domestic and international determinants.

The last time you were here, on March 3, you said that the inflation we were seeing was caused by a series of international factors mainly, and less so by excess demand domestically. Would you say that has changed?

Mr. Tiff Macklem: Generally speaking, that hasn't changed much. The main factors behind the inflation we are seeing here, in Canada, are international, including, as I mentioned, higher oil prices and supply chain disruptions. However, with the strong recovery, the economy has moved into excess demand. Demand is outpacing supply, and that is clearly being felt domestically in markets such as housing. Those pressures are at work here, in Canada.

International factors play a more important role, but with the economy now in excess demand, moderating spending growth is necessary to rebalance supply and demand and return inflation to target.

Ms. Nathalie Sinclair-Desgagné: Thank you.

Continuing along the same line of questioning, I want to talk about the situation since March 3. The government tabled its budget just over two weeks ago, and I believe you indicated in the report that the budget would have a positive, but modest, impact on the Bank of Canada's efforts. How much of an impact will the measures in the budget have?

Mr. Tiff Macklem: The report we released a week and a half ago does not reflect the measures in the federal government's most recent budget because the tabling was too close to our publication date.

As I mentioned during the press conference, the impact will be positive. You are correct. The measures represent approximately $30 billion over the next five years. While that is positive, it will not really have an impact on our macroeconomic predictions. Those measures will be taken into account in our next set of predictions, which will be published in July. The budget measures may have an impact on some aspects, but they will not affect our macroeconomic predictions.

● (1130)

Ms. Nathalie Sinclair-Desgagné: Thank you.

If I understand correctly, then, your last report does not necessarily examine the budget measures.

As you said, we are still in the midst of the pandemic. Again this morning, I received telephone calls from people and business owners in the tourism, hospitality and event sectors. They really need help because the clientele has not returned.

This is an industry that is very much in trouble. On one hand, sectors are having problems because of supply chain issues, and on the other, the economy is in excess demand.

Where does the Bank of Canada stand on the fact that it now has an arbitral role, having to balance moderating inflation and stimulating the economy, as you said?

Mr. Tiff Macklem: The pandemic impacted a number of sectors very unevenly, and thanks to the strong recovery, that unevenness has significantly smoothed out. That's a very positive effect of this strong recovery.

The economy has fully recovered from the pandemic, now moving into excess demand. That doesn't mean that every single sector has recovered from the pandemic. Some sectors are indeed still being affected, in particular the tourism sector, but the other sectors have more than made up for that.

Our mandate revolves around inflation, so it's very macroeconomic. We have to look at the economy as a whole, and it has just entered a period of excess demand.

Ms. Nathalie Sinclair-Desgagné: I see.

Thank you.

The Chair: Thank you, Ms. Sinclair-Desgagné.

[*English*]

We are now moving to the NDP and MP Blaikie for six minutes.

Mr. Daniel Blaikie (Elmwood—Transcona, NDP): Thank you very much.

Thank you, Governor Macklem and Deputy Governor Rogers, for joining us here today.

We were talking about this a little bit earlier, wage growth being considered a factor in inflation. We talk about price increases. I looked at the report that you put out not that long ago, where profit growth factors into the analysis of the Bank of Canada.

There have been several studies out in the last four weeks or so that indicate a very extraordinary rate of profit growth in Canada's corporate sector among a number of different industries showing a much higher rate of profit-making compared to 2019 before the pandemic. I think David Macdonald at the Canadian Centre for Policy Alternatives has estimated that those increased corporate profits might be responsible for up to about one quarter of inflation in the Canadian context at the moment.

Not having seen a discussion of corporate profit in your report, I'm wondering if you're tracking that, where it fits in the framework, and what reflections you might have for the committee today on the role of price increases that go beyond increases in costs to companies that are delivering goods and services in the Canadian economy.

Mr. Tiff Macklem: I'll make a few comments here.

First of all, the economy is strong. That means, yes, when the economy is strong, companies tend to do well, profits are healthy and wages go up.

We do look at how income gets divided between labour and business. Clearly you want shared prosperity. The other thing I would say is that—and this gets to price increases—for a long period before the pandemic.... We regularly go and talk to businesses. We survey them. We have a quarterly business survey, and one of the questions we ask them, when they get increases in their input costs, is if they are passing those on to their customers.

Typically what they tell us is that, yes, there's going to be some pass-through, but competition is really tough, our customers are very price sensitive, and it's very hard to pass those through, so there's very little pass-through.

Currently, against a background of an economy that's moving into excess demand, against a background of an economy where prices are increasing overall, what we're hearing is companies telling us that they're passing through price increases more quickly to consumers.

The best way to deal with that is really to get inflation down, to re-establish price stability.

One of the benefits of low, stable inflation is that then price increases stand out and consumers react and businesses are sensitive to that. That's one important reason why we need to get inflation back down, and that's why we're raising interest rates.

● (1135)

Mr. Daniel Blaikie: When we hear that corporate profit margins averaged 9% in 2019, and now are averaging 16% in 2021, that seems like more than passing on rising costs to consumers. The profit margin wouldn't be increasing at such a high rate if it really was just a case of passing on costs, as those costs would eat up the additional revenue if there was a one-to-one ratio of increased costs to increased price. Clearly, with an almost 50% increase in profit margins over the last two years, those price increases are more than passing on increased costs to consumers, there's quite a bit more happening in there. Of course, if you break it down by industry, there are going to be differences, but there are several industries where there's a pretty strong profit growth by significant amounts that would seem to dwarf whatever their increase in costs are, or presumably, there would be no increase in profit if consumers were just paying the additional costs of the company in delivering the good or service.

Mr. Tiff Macklem: As I said when I began, the economy is strong. Businesses see strong demand for their products, which gives them pricing power. Profits are normally quite procyclical, and we're in excess demand. We need to moderate spending, we need to bring demand and supply in line, and that's the best way to re-equilibrate the situation.

Mr. Daniel Blaikie: Where significant price increases or significantly larger profits are behind price increases, and it's not just a case of passing on costs, those price increases are part of the inflation story, are they not? If companies are taking an opportunity in the market of reduced competition, because of interference with global supply chains or whatever the reason may be that they have more pricing power in this current market, and part of that is just elevated demand, particularly for goods, because people haven't been able to spend on services to the same extent.... In that context, if companies see an opportunity to increase their profits, they will also be increasing inflation.

I would say it's not really part of the narrative that's been told about inflation. But if those exceptional price increases and profit growth are responsible for up to 25% of the inflationary package that Canadians are experiencing in their current budget, while I respect that that's not something you can deal with from a monetary policy perspective, ought it not to be an important part of the narrative so when government is looking at its fiscal policy and other measures, they're sensitive to the fact that that may be going on and feel an obligation to take action?

Mr. Tiff Macklem: Let me be clear, my message to companies is that they should not expect current rates of inflation to continue, that shouldn't be reflected in their pricing decisions. We've been very clear we are raising interest rates, we need to raise interest rates to slow spending and bring inflation back, and that's what companies should be expecting as they take their pricing decisions moving forward.

● (1140)

The Chair: Thank you, MP Blaikie, that's the time.

We're moving into our second round, members.

In this round, we have the Conservatives up first.

MP Chambers, you have five minutes.

Mr. Adam Chambers (Simcoe North, CPC): Thank you very much, Mr. Chair.

Thank you, Governor, it's nice to see you. Deputy Governor, welcome.

I hope we've perhaps set a precedent that until our inflation gets back into the control range, we'll see you regularly at this committee, but we'll leave that scheduling for later.

I think the central bank governors have one of the toughest jobs these days. I appreciate that in your responses to my colleague you mentioned that you've gotten some things right, and you've gotten some things wrong. That's a refreshing statement. I think we'd all be better served perhaps if members of the executive branch had the same level of humility.

I want to take you back to the fall of 2008 when central banks coordinated a 50-basis-point decrease as a response to the financial crisis at the time, I believe that was an off-cycle rate for a number of the countries that participated. It was reported that last week in the IMF meetings you had said it's on the table to do something more than 50 basis points. I'd like to give you the opportunity to expand a bit on that comment. Is more on the table and is there some coordination amongst central banks on the upside, if they could coordinate on the downside?

Mr. Tiff Macklem: I'll start with the second part.

Central banks around the world were looking at very similar things. The reality is that different parts of the world are coming out of this pandemic at different speeds, so while I think the direction of travel is pretty similar across central banks—or at least most central banks—the speed and the pacing and the size are going to depend on the situation in that country. Actually, that is the big advantage of having your own currency, your own monetary policy. It's that you can direct your monetary policy to the situation in your country.

On the first question regarding my comments, I guess I'd highlight a few things. A week and a half ago, we raised our policy rate by 50 basis points. That is unusual. Our typical step is 25 basis points. We also began quantitative tightening. Together, this was quite significant, and we signalled to Canadians that they should expect further increases in interest rates. We said that we needed to normalize monetary policy reasonably quickly.

As we get to our next decision, the typical step would be the 25 basis points. As I said earlier, I expect we will be considering a 50-basis-point increase. I'm not going to rule out other options, but anything bigger than 50 basis points would be very unusual.

Mr. Adam Chambers: Thank you very much.

I have about a minute and a half and I have two questions, so I'll need to be brief.

On raising rates to control inflation, are you comfortable—or is the bank comfortable—with risking a recession to do that?

Mr. Tiff Macklem: As I said earlier, we think the economy can grow solidly and bring inflation back to target. I won't pretend it isn't delicate, but with an economy that's in excess demand and a labour market that's got very high levels of vacancies, if we can get this right, we can reduce those vacancies, keep strong employment and get inflation back to target. That's our aim.

Are there some risks? Yes, there are some risks. The only thing I would say is that we take each decision at a time. We're going to be watching the effects of higher interest rates and how they bite on the economy. We'll be watching how that's affecting inflation, and we'll calibrate our decisions for what the economy needs to achieve our mandate.

Mr. Adam Chambers: Thank you. That's very helpful. We'll maybe pick this up in the next round.

You now have a slightly modified mandate, which includes reference to employment, but I notice that the bank doesn't project employment levels. That's interesting to me also because of the private sector economists who are projecting employment levels and are projecting unemployment to remain at a very low level and inflation to come down at the same time. I don't think in the last 50 years that has ever happened in any advanced economy.

Are you concerned, are you projecting employment internally and will you start to project it publicly given that it's now reflected in your mandate?

● (1145)

Mr. Tiff Macklem: On the questions about employment, what we have begun doing—and I think has served us very well—is that we began publishing a wide range of labour market indicators. We actually updated that work with the publication of our monetary policy report a week and a half ago. I can come back and expand on that if you like.

The analysis of the labour market has been very useful through every stage of this pandemic. In the darkest moments, as I said in my opening remarks, unemployment was 13.4%. For many sectors, it was a lot worse; low-wage workers and women were particularly affected.

Now when you look at the labour market, you see that almost all of the indicators suggest that our labour market is very tight and has moved into excess demand, and that is being reflected in our monetary policy decisions.

Mr. Adam Chambers: Thank you.

The Chair: Thank you, MP Chambers.

We're moving now to the Liberals and MP Baker for five minutes.

Mr. Yvan Baker (Etobicoke Centre, Lib.): Thank you very much, Mr. Chair.

Thank you, Governor, for being here with us today.

I want to start by thanking you for showing, on your lapel, your support for the Ukrainian people. I also want to come back to something my colleague Julie Dzerowicz asked you about in her round of questioning. She asked you about your response to being sanctioned, and I believe you called it “trivial”. I don't disagree with your characterization, but I want to say that I think that what's not trivial is the fact that you and many others in this country are being sanctioned, which is a symptom of the fact that Canadians and Canadian leaders are playing an important role in supporting the people of Ukraine. I want to thank you for that support.

With that, Governor, my first question is around the causes of inflation. At this committee today there's been an ongoing discussion about the root causes of inflation. It's being discussed in the media across the country. As part of that dialogue, there's been some discussion that the bank's so-called “money printing” is the reason we see inflation where it is today. Could you comment on whether those characterizations are accurate?

Mr. Tiff Macklem: We had a very strong response in the depth of the pandemic. Two years ago the economy was in a huge hole, roughly 15% below its prepandemic level, and monetary policy, which included lowering the policy rate using exceptional forward guidance and quantitative easing, was instrumental in supporting the recovery. I'm certainly not going to take all the credit. Fiscal policy, very effective vaccines and just the adaptability and resilience of Canadians were extremely important as well.

I guess the way I would put it is that we're raising interest rates now, and we've signalled that we need to normalize monetary policy reasonably quickly. That's not because our policies failed. That's because they were very effective, and we're now dealing with the other side of that.

As I've said, did we get everything right? No. We have been surprised, in particular, by the persistence and the pervasiveness of these supply constraints. Inflation is now too high, and we are normalizing policy to bring inflation back to target, and Canadians should be confident that we will succeed.

● (1150)

Mr. Yvan Baker: Thank you very much.

Let me start with this. Do you believe there is a way for Canada or for Canadians to entirely opt out of inflation? Specifically, are cryptocurrencies a way, for example, to opt out of inflation?

Mr. Tiff Macklem: I'm going to ask our senior deputy governor to weigh in on that one.

Ms. Carolyn Rogers (Senior Deputy Governor, Bank of Canada): One of the benefits of low and stable inflation is that prices remain stable. I think that if Canadians are looking for a stable source of payment and stable value, cryptocurrencies don't really meet that test. Over the last year or two, the volatility of cryptocurrencies has been higher than that of gasoline, the Canadian exchange rate and most commodities, so we don't see cryptocurrencies as a way for Canadians to opt out of inflation or as a stable source or value.

Mr. Yvan Baker: Thank you.

We've seen over the past few months a few instances in which cryptocurrencies have been used to avoid global sanctions, such as those placed on Russia, or to fund illegal activity. The federal budget is putting forward $17.7 million to launch a financial sector legislative review, with its first priority being a review of cryptocurrencies and stable coins.

I have only about 30 seconds left, but could you briefly discuss the risks to financial stability and national security caused by the rise of digital assets and cryptocurrencies?

Ms. Carolyn Rogers: I think this is exactly what the legislative review is designed to look at. Cryptocurrencies or the underlying technology in cryptocurrencies holds some promise. There's some important innovation there, and I think the legislative review will allow us to explore that innovation but also to look for ways we can get at those benefits in a more regulated environment to make sure Canadians who want to use these digital forms of payment are also protected.

We don't see a trade-off between innovation and regulation oversight, but certainly with the increase in digitalization in the financial sector, it's important that we undertake the right level of research and development. That's what the central bank is doing right now, and that's what the legislative review is designed to do.

Mr. Yvan Baker: Thank you.

The Chair: We are moving to the Bloc and we have Madame Sinclair-Desgagné for two and a half minutes, please.

[*Translation*]

Ms. Nathalie Sinclair-Desgagné: Thank you, Mr. Chair.

Similar to my previous line of questioning, I'd like to talk about domestic and international determinants of inflation. Canada introduced a variety of support measures. Given that the determinants of inflation are for the most part international, and to a lesser extent domestic, would extending the support measures have an impact on inflation? They are supposed to end next week. Can you say whether those programs would or would not have an impact?

Mr. Tiff Macklem: There are two parts to that answer.

The first thing is that, most of the time, inflation is caused primarily by international pressures. However, I want to stress the importance of keeping inflation expectations well anchored on our target, because if we don't, when those pressures moderate, inflation will not go down. Conversely, if those expectations are well anchored on the target, we will see a decrease.

The other aspect of inflation—and this has more to do with your question—relates to domestic pressures. Right now, the economy is in excess demand. The overall economy has fully recovered from the pandemic, and measures that further contribute to demand will exacerbate excess demand. In that case, we would have to raise interest rates further or we wouldn't be able to lower the inflation rate to reach our target. Inflation affects every Canadian's household budget, so it's very important for all Canadians that inflation remain anchored on the target.

● (1155)

Ms. Nathalie Sinclair-Desgagné: Thank you, Mr. Macklem.

The Chair: Thank you, Ms. Sinclair-Desgagné.

[*English*]

We are moving to the NDP.

MP Blaikie, you have two and a half minutes, please.

Mr. Daniel Blaikie: Thank you.

When we talk about inflation, there are certainly those who would like to say that government spending is the only determinant of inflation, so I talked a bit earlier about some of the other factors that we might see.

Looking internationally, there are as many unique examples as there are countries in the world, but Japan is a country that operates with a debt-to-GDP ratio that's astronomically higher than Canada's. It's in the region of about 250%. They've been cited by some other parliamentarians sometimes as an example of low inflation, although usually the debt-to-GDP ratio isn't included in that reference.

I wonder whether you've done some thinking about that and what lessons we might draw from comparisons with a country such as Japan, which is clearly operating its economy in a very different way from Canada.

Mr. Tiff Macklem: You have to be very careful drawing much inference from the Japanese economy to the Canadian economy. The Japanese economy is a very different economy in so many ways.

In fact, if you compare Canada to other economies that would be more comparable, such as the United States, Europe, Australia, Sweden or the U.K., you'll see much more common ground, much more similar experience. In all those economies, inflation is too high. In all those economies, monetary policy is increasingly geared towards normalizing monetary policy. That's going to happen at different paces, because the circumstances of these countries are in different places in terms of how far they are along in their recovery. Those would be a better comparison.

I would be careful about that, because there are some very unique features of Japan that other members of the G7, for example, just don't share.

Mr. Daniel Blaikie: Does that play out in conversations when you have central bankers from the seven countries sitting around the table?

Mr. Tiff Macklem: Actually, I was just in Washington and talking with Governor Kuroda.

Japan has its own monetary policy. It has its own currency. It has a flexible exchange rate. They are taking decisions that are geared to the situation in Japan, and that's being reflected in their exchange rate. That's the way the international monetary system works. Different countries will take different actions based on the situation in their country, and the international order, through the exchange system, will adjust to accommodate that.

The Chair: Thank you.

Now we'll go to the Conservatives and MP Albas for five minutes.

Mr. Dan Albas (Central Okanagan—Similkameen—Nicola, CPC): Thank you, Mr. Chair.

Thank you to the governor and the senior deputy governor for being here today in person.

Governor, you sound a little hoarse today and I think it's probably because you've been saying over and over to everyone who will listen to you that inflation is too high and that we need higher interest rates. You got a lot of things right and a lot of things wrong, the economy is moving to excess demand, and we note that you want to keep inflation expectations well anchored, and demand is exceeding supply.

Stephen Tapp from the Canadian Chamber of Commerce has noted that the nominal policy rate of 1% is still below the bank's estimate of the neutral rate, which is between 2% and 3%. He further noted that until your rate rises above 2% to 3%, “the Bank is pouring gas on the inflation fire”.

I know that the government can't help itself, it spends at any time it can, but you're different, Governor. Your institution is independent and your number one job, as of last December, is still price stability.

What is your explanation for continuing to pour gas right now on inflation?

● (1200)

Mr. Tiff Macklem: We are raising interest rates. We took the unusual step a week and a half ago of raising it by 50 basis points. We also started quantitative tightening, something that we've never done before, and we've signalled that there are more increases to come, so we are responding to the situation.

I am quite confident that higher interest rates.... If you look at five-year mortgage rates and you look at the the expectation of further increases already being priced in, that is already having an effect on the economy. I do expect that is going to moderate spending.

We don't want to overheat the economy. We also don't want to overcool the economy. While we're certainly responding and moving quickly, you do want to do this in a series of steps and look at the impact and then calibrate your response to bring inflation back to target.

Mr. Dan Albas: In your own monetary report, Governor, the report itself says that the bank typically looks to do policy on a six- to eight-quarter basis, so most of the effect of the April 13 decision won't be fully implemented and integrated into the economy until between six and eight quarters.

When did you start quantitative tightening? I believe it was last night.

Mr. Tiff Macklem: We stopped quantitative easing last November and yes, as of today, we have started quantitative tightening.

Mr. Dan Albas: Again, those changes take a long time to factor into the economy, Governor.

So the question would be, to what extent does the fact that many Canadians are heavily indebted restrict the Bank of Canada from raising interest rates to reduce inflation?

Mr. Tiff Macklem: I'm going to ask the senior deputy to take this one.

Ms. Carolyn Rogers: I'd make two points.

It's true that monetary policy is forward looking. It does take a while to work through the economy and the financial sector before it has a direct effect on inflation; however, the signalling effect of our path to normalization is already being seen, particularly in mortgage rates.

To come back to your other question, though, we are aware of elevated debt levels in the Canadian economy. It's something the Bank of Canada has been talking about for a long time now, from well before the pandemic. We do anticipate that will make the economy more sensitive to interest rate changes and we will be watching that. As the governor said, we take all of those signals in as we make each decision.

Mr. Dan Albas: With all due respect, senior deputy, Mr. Macklem was on the record where he said to Canadians at the beginning of the pandemic not to worry because “interest rates are very low and they're going to be there for a long time”, I think, for several years.

Ms. Carolyn Rogers: Low interest rates were here for a long time.

Mr. Dan Albas: I'm hearing anecdotally that we're already starting to see house prices drop in Vancouver. We're also starting to see restaurants changing their menus to reflect higher costs. As they don't know what inflation will look like, they're raising them quite high. It's the same with even a barber shop. Someone told me that their barber raised the cost of a haircut by $15, and I wouldn't say that's an area subject to inflation.

Mr. Governor, when we look at the fact that there are critics at the bank saying that you should have been moving things a year ago to start building up a slow and steady nature, what do you say to those critics, given the fact that you can't raise rates because of the heavy indebtedness of Canadians?

Mr. Tiff Macklem: It's easy to forget that Canadians have been through a lot in the last couple of years. Two years ago, our economy was 15% below its prepandemic level. Unemployment was at 13.4%. The combination of monetary and fiscal policies and very effective vaccines has resulted in a very impressive recovery, in fact, the strongest recovery on record.

The fact that we now need to raise interest rates reasonably quickly and that inflation is too high is not because our policy response failed; it's because it was very effective.

● (1205)

Mr. Dan Albas: In that case, Governor, what was the biggest mistake?

The Chair: Mr. Albas, it's time. We're at six minutes. We've gone one minute over already.

Mr. Tiff Macklem: Can I respond to the mistake?

The Chair: You can respond quickly, please.

Thank you, Governor.

Mr. Tiff Macklem: As I said to previous questions, I think we got a lot of things right. We did get some things wrong. We have been surprised, in particular, by the persistence and the pervasiveness of the supply shocks. The supply shocks were very focused on very specific things such as computer chips. What we have seen since then is that they have broadened. They're really affecting all goods.

Yes, our inflation outlook is higher. It's higher for longer. It does take some time for monetary policy to work through the system and bring inflation back to target. That's why we are moving relatively quickly to normalize monetary policy, keep inflation expectations well anchored, and bring balance between demand and supply in the economy.

The Chair: Thank you, Governor.

Thank you, MP Albas.

Members, I do try to find the most natural transition where we can go from one member's questions to the next member. We did go a couple of minutes over.

We are moving to the Liberals and to MP Chatel for five minutes.

[*Translation*]

Mrs. Sophie Chatel (Pontiac, Lib.): Thank you, Governor and Senior Deputy Governor.

I have a few questions about the causes of inflation. Clearly, some would prefer to oversimplify a problem as complex as inflation, but as you made clear, inflation is a global phenomenon. I had a look at the latest figures, and Canada's inflation rate of 6.7% is nevertheless below the OECD average of 7.7%, the G20 average of 6.8% and the euro zone average of 7.3%.

I want to commend you. In your recent monetary policy report, you do an excellent job of summarizing the domestic and global determinants of inflation, specifically in box 4 on page 17. Now, no one can oversimplify the causes of inflation, with the very clear overview you have provided.

In particular, you mention homeowners' replacement costs. The committee actually studied inflation in the housing sector, among other things.

Can you talk more about that?

Mr. Tiff Macklem: Yes, of course.

First, I would say that, in Canada, inflation is slightly below the average in other countries, but Canadians feel it is too high, and clearly, we need to control inflation.

As for housing prices, what we have seen is a significant year-over-year increase of about 25%.

That factors into the consumer price index, or CPI, but not on a one-for-one basis. With the CPI, the idea is to measure the cost of the service being received, in other words, the house or dwelling. However, the cost of the service, to replace or improve the home, is based on the measure used for new homes. It is part of the CPI but does not have a direct impact.

If we look at the cost of housing within the CPI, we see clearly that it is rising sharply, and that reflects pressures here, in Canada. They are domestic excess demand pressures, not international pressures.

Mrs. Sophie Chatel: Thank you.

By including the information in the monetary policy report, you've opened the door to better policy-making, and that will help us address the problem of inflation.

Thank you for your work.

● (1210)

[*English*]

You said earlier that it's important not to overheat the economy, and not to overcool it either, and that's a thin balance. How do you weigh the trade-off between the risk of inflation and a possible recession? That's what's at stake here.

Mr. Tiff Macklem: As I said, our own forecast has growth slowing, but remaining quite solid with inflation coming down, so we do think.... Even if growth is a little weaker than in our projection, there's still some room for it to be a little weaker and be positive. We do think there is a way forward with inflation coming down and reasonably solid growth.

As I said, it's going to be delicate; that's why we take the decisions one at a time. If the economy starts slowing faster than we expect, if inflation starts to come down faster than we expect, we do need to get rates.... Rates are still very low. We do need to get them up closer to neutral, but if the economy starts to moderate more quickly, it could be appropriate to pause and reassess for a bit.

I would stress that at the end of the day, our mandate is to control inflation. Getting that soft landing is how you control inflation. We want inflation to come down to target; we don't want it to go below the target, so that's what we're focused on doing. We are going to use our tools, and we're prepared to use them forcefully if needed to bring inflation back to target.

The Chair: Thank you.

Members, we are moving into our third round of questions.

We have the Conservatives up first with MP Stewart for five minutes.

Mr. Jake Stewart (Miramichi—Grand Lake, CPC): Thank you, Mr. Chair.

Thank you for being here.

You mentioned earlier that you got some things right and some things wrong. Could you explain exactly what you got wrong?

Mr. Tiff Macklem: If you go back to our January report, we were expecting inflation to peak at around 5%. We were expecting that by this point we would be starting to see some early signs that inflation would be starting to turn. The latest March CPI number at 6.7% is obviously well above 5%.

The other thing that is even more significant from our perspective is that for the outlook for inflation, the track is higher. If you go back to January, we thought we'd be around the top of our 1% to 3% control range by the time we got to the end of this year. We now think we'll probably be 4% and something around the end of this year.

It's not just that it's gone up, but it's going to be up for longer. It's going to take longer to come down.

That's the sense in which we have been surprised by the persistence and pervasiveness of these supply shocks. We've obviously been surprised by the unprovoked attack of Ukraine. These things are not going to work.... The war is ongoing. I don't know when that war is going to end. For the sake of everybody, I hope it ends very soon, but it's further disrupting supply chains. Outbreaks of COVID in China are going to further disrupt the supply chain.

It's going to last longer and there is some uncertainty. What there isn't any uncertainty about is the Bank of Canada's resolve to use its tools to bring inflation back to target. We are responding where we have been surprised. That's really the value of having a clear mandate.

Mr. Jake Stewart: Thank you.

A few years back, the central banks and you, yourself, predicted deflation. I forget your exact wording, but it was just a prediction on deflation.

Could you explain that prediction and the result of it?

● (1215)

Mr. Tiff Macklem: Two years ago I wasn't the governor. Two years ago and through the early part of the pandemic, the economy suffered its biggest collapse in history. GDP plummeted 15%. The unemployment rate shot up from 5.7% to 13.4%. Roughly three million Canadians were out of work and more than another three million Canadians were working less than 50% of their hours.

This was a situation where there was a serious risk of deflation. There was a huge amount of excess supply in the economy. Many Canadians were not working and if there hadn't been a really concerted policy response, there would have been a real risk of deflation.

Why is deflation so damaging? When a deflationary mindset sets in, people think prices are going to fall and their tendency is to wait and buy things later when prices are lower. Things are already really weak, so when people decide to wait and buy things when prices are lower, that just weakens the economy further. In an economy that has a relatively high level of household indebtedness and a mortgage payment is a fixed nominal value, getting less income makes those payments become more dangerous.

Those comments were very much in the context of an economy that was in danger of deflation. We were not predicting inflation. We took bold action to, first of all, put a floor under the decline and then support the recovery. We weren't predicting deflation, but we were indicating that were we not to take bold action, that could very well be what would happen.

We saw from the Great Depression.... Why is it called the Great Depression? There was a big decline and then a very prolonged period of an incredibly weak economy. A lot of people suffered as a result.

The Chair: Thank you, MP Stewart.

Now we'll go the Liberals and MP MacDonald, for five minutes, please.

Mr. Heath MacDonald (Malpeque, Lib.): Thank you, Chair.

Thank you to the governors for being here again today. It's always an interesting discussion.

It's good to hear. I asked questions before, relative to quantitative tightening, normalizing your balance sheet and how quickly you can do that without having too much negative effect on the economy.

I want to go back to the market certainty, or let's say, signalling effect. You talked about it briefly with my colleague MP Albas. In signalling interest rate hikes, what does that do to the markets? Can you just give us a little more overview on how that affects inflation?

Mr. Tiff Macklem: Yes. The first point I'd make is that the most important audience is Canadians. One thing we've learned is that monetary policy works better when people understand it. Also, when people understand monetary policy, they understand our objectives, they understand our tools and they tend to have more confidence in monetary policy. Our business, at the end of the day, is confidence in the value of money, so confidence is paramount. In explaining to Canadians what we're doing, why we're doing it and what they should expect, that's important so they can hold us accountable and this committee can hold us accountable. Canadians and this committee should hold us accountable. It also, though, helps monetary policy actually work.

With respect to markets, markets have an insatiable appetite for as much certainty as we can give them, and where we have reasonable conviction about the direction, we will give it. Where we think we need to be more humble, we will indicate that we need to be more humble. Markets will read our monetary policy report with interest, they'll certainly listen to our statements, and they'll come to their own conclusions.

Monetary policy works through markets. It is important that markets understand what we're thinking, and in particular, what we're looking at. That's one of the reasons we put out a fairly detailed forecast. We put out our outlook, and as data comes in, the market can see whether it is coming in stronger than the bank said or weaker than the bank said. Then they can come to their own conclusions.

● (1220)

Mr. Heath MacDonald: Thank you.

How does Canada preserve our low debt position going forward?

Mr. Tiff Macklem: Questions of fiscal policy are really for the government and ultimately for Parliament to decide on. Canada is in a relatively good position relative to at least the rest of the G7.

How do you preserve it? Well, don't spend too much relative to your revenues.

Mr. Heath MacDonald: Thank you.

I struggle with, recently, seeing provinces across the country coming in in the black and everyone knows we're talking about inflation at the federal level and we're talking about surpluses or provinces being in extremely good shape. I often wonder how you provide an economic outlook based on those factors to society in general, to the layman.

Mr. Tiff Macklem: There are a couple of points there. First of all, governments have a range of priorities. They have economic priorities, they have social priorities, they have health priorities, education, security and defence. There are many priorities and you have hard jobs. At the Bank of Canada, we have one job, and that is to control inflation. What we do is take announced provincial and federal budgets as given and we put those into our models. We put that in with everything else, with the dynamics of the U.S. economy, with commodity prices, with other factors, and we update our projections. Those are useful inputs. Those are important inputs into the decisions we take to deliver on our mandate.

Mr. Heath MacDonald: Thank you.

[*Translation*]

The Chair: Go ahead, Ms. Sinclair-Desgagné.

Ms. Nathalie Sinclair-Desgagné: Thank you, Mr. Chair.

The issue I'd like to discuss may seem a little unexpected today, but it is just as relevant. I'm talking about the central bank's role in ensuring a stable financial system. It's funny because you just talked about that. The central bank's primary function is to control inflation, fostering confidence among investors and within the economy and thereby ensuring medium- and long-term growth.

You are one of the few public policy-makers who have to play that role in the medium and long terms, unlike lawmakers and parliamentarians.

Climate change poses a fundamental risk to our economy and the stability of our financial system. I commend you on the publication entitled “Assessing Climate Change Risks to Our Financial System”, which came out in January.

I'd like to know where we stand, given that other major economies have examined the issue and incorporated climate risks into their financial systems, despite the pandemic. Where is our central bank on the issue?

Mr. Tiff Macklem: I'll answer first, and then, I'll turn it over to Ms. Rogers to speak to price stability.

The first thing I want to point out is that climate change policy is decided by the government and Parliament. It is not our job to come up with climate change policy, but we do have a role to play.

Two aspects of our mandate are affected by climate change.

First, climate change can affect the stability of the financial system. A very quick change in certain asset prices could impair the financial system and have a negative impact on the economy. Ms. Rogers can give you more information about the study.

Second, climate change can affect monetary policy. Climate change can have a significant impact on the economy. That is especially true when it comes to the transition to a lower carbon economy, which will require huge changes. To fulfill our mandate in relation to price stability, we have to understand, and take into account, those negative effects when considering monetary policy.

● (1225)

[*English*]

Ms. Carolyn Rogers: With your permission I'll reply in English.

You referred to the study that we published in January. We did this jointly with the Office of the Superintendent of Financial Institutions, and the objective was to look at how climate change could potentially impact stability in the financial sector. Our number one job as a central bank, as the governor said, is price stability, but part of that job is looking at the overall stability of the financial sector. This is why we look at climate change.

The key message for us that came out of that study is that for an economy like Canada, particularly an economy that's dependent or has a large fossil fuel sector, there will be major structural changes regardless of how we deal with climate change. We're already seeing some of those effects. If you lived through last summer, you could see the effect of climate change on the Canadian economy, and it came at a time when we were facing other pressures.

The bottom line of that study is that there are structural changes that need to happen. The longer the runway we can give ourselves to deal with those changes, the less destructive they will be. If we delay policies, if we delay work to deal with those structural changes, they will become increasingly disruptive and have a negative effect on financial stability.

[*Translation*]

The Chair: Thank you, Ms. Sinclair-Desgagné.

[*English*]

We're moving to the NDP, with MP Blaikie for two and a half minutes.

Mr. Daniel Blaikie: Thank you very much.

Governor Macklem, earlier in your remarks, I think you made reference to the fact that one of the things happening in this pandemic period has been a reduction in the demand for services and an explosion in the demand for goods of all kinds as people were at various times confined to quarters, so to speak, and looking for things to do and ways to improve their homes. Things are opening up a bit. It's hard to tell how reliable a trend that will be, depending on what happens with the virus, but things do seem to be opening up. There does seem to be a trend line there towards more open economies and more travelling of people between countries as well.

I'm wondering what signs you might be looking for when you talk about trying to dampen demand with rising interest rates, and if part of what's going on is an explosion in demand for goods as people are able to access services that they weren't able to access over the last two years. That will have its own dampening of demand within the goods sector, which is, I think it's fair to say, one of the main driving areas as between goods and services where inflation is occurring.

What are you looking for in order to get a sense that we might be seeing a return to a more normal balance between demand for goods and services and what that means for the bank as it contemplates interest rate hikes and other monetary policy initiatives?

Mr. Tiff Macklem: Yes, it is exactly as you've outlined. Through the pandemic, for services people wanted to buy and consume, they couldn't do it because that required close contact, so what happened was that people substituted that with goods. They couldn't go to the gym, so they bought home fitness equipment. They couldn't go to restaurants, so they bought better kitchen equipment. You could see this in the housing market in general. Many Canadians were working at home, their children were going to school at home and all the recreation was at home. Not surprisingly, they wanted bigger houses. That showed up in the housing market. If you want a bigger house, you want more furniture and new appliances.

Usually during recessions it's these durable goods that get hit more, because you can keep your old couch a little longer, but during the pandemic you were sitting on it all day. You were using it a lot more. It was very unusual, this big shift in demand for goods, and it wasn't just in Canada, it was globally. The effect of the very strong demand for goods, with these disrupted supply chains, is that we've seen very large increases in the prices of these goods.

As the pandemic recedes, we actually think that there will be some natural rebalancing of demand. We're already seeing it. People want to get back to going to the gym, going to their local restaurant and getting out, so what we expect to see is that the demand for goods will diminish as the consumption of services increases.

Now, overall, though, demand is running ahead of supply, so the average of that has to grow more slowly going forward than it's grown in the past, or else we're going to have ongoing inflationary pressures, so there are two things going on. We are looking very closely at this rotation from goods to services.

So far, what we've seen is a strong rebound in services. We're not seeing much reduction in demand for goods, and some of that may be related to these supply constraints. If you're trying to buy a car, well, it may take six months for you to get that car and for that sale to show up. We're not seeing yet much reduction in demand, and that's one of the reasons why the economy is strong. Hopefully, as those supply constraints diminish, people get the goods they wanted and we start to see more rebalancing. That's something we'll be watching closely.

● (1230)

The Chair: Thank you, MP Blaikie.

We're now moving to MP Fast for five minutes.

Hon. Ed Fast: Thank you very much.

Again, Governor, thanks for coming. We always appreciate you coming here and having an honest dialogue about the issues that are facing Canadians, especially at a time when we have this affordability crisis across Canada.

Given the current cost–of-living crisis, I think it's reasonable for Canadians to ask whether our Canadian dollar is safe and to ask you, as the governor, what the best hedge against inflation is.

Mr. Tiff Macklem: The best hedge against inflation is to get inflation down, so that people could stop worrying about it. That is really our primary focus.

With respect to the Canadian dollar, the Governor of the Bank of Canada does not give investment advice. The Canadian economy is strong. Canadians can have considerable confidence in the Canadian economy. They can have considerable confidence in the value of our currency. Our financial system is very stable. It has weathered this pandemic extremely well. Our trade situation is reasonably good. For many of the goods we export—oil, wheat, potash—prices are high, and global demand is very strong. The Canadian economy is in good shape.

Bringing it back to our mandate, the Canadian economy can handle higher interest rates. In fact, it needs higher interest rates.

Hon. Ed Fast: I note Ms. Rogers' earlier comments about cryptocurrencies, and that they're not an appropriate hedge against inflation. I note that the Bank of Canada issued a staff report that addressed the issue of Bitcoin awareness, ownership and use. What jumped out at me was a statement:

> Bitcoin owners were susceptible to certain risks, as evidenced by the fact that about half of current and past owners stated they had been affected by events such as price crashes, losing access to funds, scams or data breaches.

Are those some of the reasons why the bank doesn't recommend cryptocurrencies as a hedge against inflation?

● (1235)

Ms. Carolyn Rogers: Certainly. I don't think the bank recommends hedges, in general, but certainly, those are some of the reasons we don't see cryptocurrencies as a stable form of payment.

Hon. Ed Fast: Thank you for that.

Do you expect cryptocurrencies, either in the near or medium term, to ever replace the Canadian dollar as our legal tender in Canada?

Ms. Carolyn Rogers: As I said earlier, the government has initiated a study to look at digital currencies, in general, and to look at how their increasing popularity is affecting the economy and financial stability. One of the things that we've been studying for a number of years is whether or not we need a national digital currency, a central bank digital currency. As I said earlier, there are many underlying benefits to the innovations in digital currencies. They may hold potential to bring more efficiency to payments, and more competition to the financial sector.

It's really worth studying. The central banks have been doing that for quite a long time now. We have actually moved from a research stage into an early development stage.

Ultimately, whether or not Canada will have a central bank digital currency is a decision that Parliament will make. It's not one that the Bank of Canada will make. We view our job as to be ready, to have done the work ahead of time, so that if we decide that a central bank digital currency is something that would benefit Canadians, we're ready to provide it.

Mr. Tiff Macklem: I'll add that there are promising benefits from innovation in the financial sector. Having said that, we certainly expect the Canadian dollar will remain at the centre of the Canadian financial system.

Hon. Ed Fast: That's what I wanted to know. Thank you.

The Chair: Thank you, MP Fast. That's the time. I know it went very quickly.

We're moving to the Liberals, and MP Dzerowicz, for five minutes, please.

Ms. Julie Dzerowicz: Thank you, Mr. Chair.

I'm hoping to ask three questions. The first one is on one of the motions that's before our committee that I'm hoping we get to study at some point. It deals with harmonizing regulations in Canada, across the provinces and territories, and eliminating all barriers that hinder the movement of goods, services and people.

To what extent do you think this is a priority for Canada, and how do you think it would impact Canada's growth and productivity?

Mr. Tiff Macklem: One of the things, to get back to one of your earlier questions, was the importance of productivity growth. I underline that productivity growth is at the foundation of rising standards of living.

When we look at things like interprovincial barriers to trade, you have to wonder what the purpose of these barriers is. We have a union. We have a country. To the extent that we can harmonize and have a free flow of goods and labour across the country, that means that resources can go to their highest value and their highest productivity.

It is something that governments across this country could do to improve productivity, and one of the beauties of it is it doesn't cost you a cent.

Ms. Julie Dzerowicz: Do you think it's a priority for us?

Mr. Tiff Macklem: I think that we've seen through this pandemic tremendous levels of co-operation across this country, and I think it would be a good time.

This is a long-standing issue and there certainly has been some progress in some dimensions, but I think this would be a good time, because improving our productivity growth....

Productivity growth has been too weak for too long. We have grown more in this country through additions to the labour force. That's been great, but as we move forward, the labour force is going to be aging. We're not going to get as much labour force growth, and that is going to put more emphasis on the need for productivity growth for the Canadian economy to continue to grow at the pace it's been growing.

● (1240)

Ms. Julie Dzerowicz: Thank you.

My next question is about something that was part of your opening remarks. You talked about inflation and how it's impacting all Canadians but, most particularly, those on the lower end of the income scales, the most vulnerable.

Now that most of our social benefits in this country—the CCB, Canada worker benefit, OAS, CPP—are indexed to inflation, will that be helpful to alleviate some of the stress around inflation, and/or is there more that we should be doing at the national level to better support our most vulnerable?

Mr. Tiff Macklem: I know I've given you this answer several times, but the best way to solve this problem is to get inflation down.

Yes, the most vulnerable members of society are particularly affected by inflation. With the fact that inflation is quite broad now, more than two-thirds of the CPI basket is rising over 3%. Even if you are a very careful shopper, you cannot avoid higher prices, and there is a role for governments to protect the most vulnerable members of society.

Monetary policy is a broad macro tool. We can't target specific individuals. Those are decisions for governments and Parliament.

Ms. Julie Dzerowicz: When I read about market insight globally, there are a number of economists who feel that monetary policy has been co-opted by markets, and that there is a need to return monetary policy to serving more of the real economy, rather than financial markets.

To what extent is that an issue in Canada? To what extent is this something that you're concerned with?

Mr. Tiff Macklem: Monetary policy works through markets. We have a modern, market-based economy in Canada, and markets are at the core of a lot of our prosperity.

Monetary policy has a very clear mandate. We make our decisions to pursue our mandate in the best interests of Canadians, and markets adjust to that.

I don't think this is a problem in Canada.

Ms. Julie Dzerowicz: Thank you.

The Chair: Governor and senior deputy governor, thank you for all the questions you've been answering.

We are moving into our final round. I know members still have a lot of questions.

I'm looking at the time, members. As we do on this committee, when we don't have enough time for a full final round, we divvy up the time equally. I'm looking at about three or four minutes for each party.

We'll start with the Conservatives. I believe it's MP Chambers.

Mr. Tiff Macklem: We will try to shorten our answers.

Mr. Adam Chambers: Excellent. I much appreciate it.

You mentioned excess demand. Has some of this excess demand been created by the overly loose monetary and fiscal policy that we see?

That has to be a somewhat contributing factor to the excess demand that we see, like kind of a simple—

Mr. Tiff Macklem: Our policies have been very effective in getting us out of a huge hole. The economy has moved into excess demand and now it's time to adjust to that.

We have certainly started. We signalled very clearly to Canadians. We have some more work to do.

Mr. Adam Chambers: That's fair enough.

Earlier, you mentioned spending. There was a 25% increase in government spending from prepandemic levels to now. Blink twice if you feel like you're being held hostage by overly loose fiscal policy. I'm just kidding. Don't answer that. I know you won't.

The risks to the outlook seem to be painted as still rather optimistic when it looks like the best-case scenario is being presented as some of the base case. I know we have increased inflation a bit, but wage growth in the U.S. has been significant. Again, government spending continues to be significant. On household balance sheets, there's still a lot of money sitting in bank accounts. If we're in excess demand, that gets deployed. I think that's a bit of a risk.

The bank again says that the risks to the outlook are balanced. I think that's probably the fourth or fifth time we have heard that.

What makes this time different from some previous times?

● (1245)

Mr. Tiff Macklem: I will say two things.

I think there are risks on both sides and there are some upside risks. You highlighted a few of them. The balance sheets of Canadians are better. Canadians do have roughly $200 billion of excess savings—it's a funny word—or more savings than we think they would have had if there hadn't been a pandemic. It comes back to Mr. Blaikie's question. They haven't been able to consume a lot of things they wanted to consume, so they have been saving the money.

In our outlook, we are assuming that they spend a good part of that, but they could spend more, so there could be some upside risks.

There are also some downside risks. We have been pretty conservative in our assumptions. We're not assuming that there are any price reversals in these durable goods prices. We think they are going to stabilize, but they don't fall back. If there are reversals, inflation actually could come down faster.

There are risks for both sides, but my second point is important. With inflation at 6.7% and with an outlook for inflation remaining well above our target range for the whole of this year, we are more concerned about the upside risks than the downside risks.

Mr. Adam Chambers: Thank you very much.

We're going to see used cars now added next term, so that's going to bump it up even more.

We have never been more indebted as a nation—private sector debt, public sector debt and consumer debt. That's another significant risk.

Should we start warning Canadians now about debt levels, more than we have been? I know you have been recently, but is this something we really need to be concerned about? We have never seen these debt levels.

Mr. Tiff Macklem: Maybe I will ask the senior deputy governor to say a word about the household balance sheets.

The Chair: Answer really quickly, please. You have 15 seconds.

Ms. Carolyn Rogers: You said it well. This is a risk the Bank of Canada has been warning about for years, well before the pandemic.

As I said earlier, we do think households and companies that have high levels of debt will be more sensitive to interest rate risks. As we point out, the excess savings sitting in household balance sheets could also moderate the effects.

We will be watching. As the governor said, there are risks on both sides.

Mr. Adam Chambers: Thank you very much.

The Chair: Thank you, MP Chambers.

Now we're moving to the Liberals.

MP Baker, you have the floor.

Mr. Yvan Baker: Thanks very much, Chair.

Governor, before Russia's invasion of Ukraine, we already had a supply chain that was choked up, which was driving up inflation around the world.

Can you characterize what the situation was then and how it's being exacerbated now by Russia's invasion of Ukraine?

Mr. Tiff Macklem: Yes. If you go back to January—and I don't have the January report in front of me—before the war, we were starting to see some beginnings of easing of these supply chain disruptions. I would say that they were somewhat tentative, but if you looked at shipping delays, for example, they'd certainly peaked and they were starting to get through. On computer chips, for example, we were seeing some evidence that supply was improving. You saw some rebound in our own car production as they got the chips that they needed.

I would say that things were not improving perhaps as rapidly as we might have hoped, but they were starting to improve.

The war has certainly been a new setback. It is causing, particularly in Europe, some new supply chain disruptions. Certain key components of the supply chain that are produced in Ukraine—or Russia, for that matter, but more Ukraine—for example, neon, are not available now.

I think that what is more significant, certainly for Canada, is that global shipping is being disrupted.

Then, the other element I would highlight is what new outbreaks of COVID and new lockdowns in China are causing. The Port of Shanghai is very backed up at the moment.

So war and COVID continue to disrupt supply chains. We do expect, as we get into the second half of the year, that these things will work their way out. However, yes, there is considerable uncertainty about these supply chains, and unfortunately that's not going away soon.

● (1250)

Mr. Yvan Baker: Thank you for that.

As a follow-up, Ukraine is one of the world's largest food producers. Russia is obviously a very large food producer as well. Because Ukraine is unable to export most of its food exports—if not all of them—could you talk about the impact that's having on global food prices? Is that impacting food prices here in Canada?

Mr. Tiff Macklem: First of all, the Ukraine economy has been devastated. In Washington last week, the finance minister from the Ukraine, Minister Marchenko, was there. I had a chance to speak to him on a number of occasions. I will say that the resilience and courage of the Ukrainians are incredible. They are moving ahead with their intention to plant their crops. Hopefully that can continue.

The big challenge, though, as you alluded to, is at the harvest: How do they get the crops, and how do they transport the crops? If they don't have access to shipping, there will be a very serious problem.

The IMF in particular, as well as the World Bank, has been highlighting the implications for food security, particularly in countries in northern Africa, which get a lot of their wheat from Ukraine. This is a serious threat.

I think the G7 and other leading nations are focused on this risk and looking at what can be done, but I won't pretend that it isn't a worrisome situation.

The Chair: Thank you.

We're moving to the Bloc and Madame Sinclair-Desgagné.

[*Translation*]

Ms. Nathalie Sinclair-Desgagné: Thank you, Mr. Chair.

I want to pick up our earlier discussion on incorporating climate change risks. Since I am asking the experts, I would really appreciate a clear and specific answer.

My question is this. What risks will the central bank incorporate into its modelling, and how? I am referring to the risks associated with global warming, as well as those associated with the transition, so all the risks. How will they be incorporated? I am especially interested in finding out when Canadians and Quebeckers will be able to rely on the central bank to incorporate those risks.

Mr. Tiff Macklem: I would point to a few things.

The first thing I should note is that the study we released lays out various scenarios. There is a lot of uncertainty around the effects of climate change and the associated risks, and we don't have the ability to make those predictions. However, having scenarios to assess those risks is extremely helpful and important.

The scenarios were based on the risks stemming from the transition to a zero-carbon economy, but the scenarios do not include physical risks, such as more frequent storms and droughts. We will nevertheless take those risks into account at a later stage.

Recent events have brought to light another aspect, time frames. Even our scenarios take into account time frames for initiating the climate transition. As Ms. Rogers pointed out, delaying policies is more costly.

That said, the scenarios are probably overly optimistic because the modelling includes assumptions for climate policy and forecasts. Under the scenarios, investments in new energy sources will become accessible as investments in oil drop, and coordination isn't really a problem.

Throughout the world, energy security is becoming increasingly important, but it isn't clear that supply will be able to meet demand.

We have a great deal of modelling work to do in terms of a scenario that involves weak coordination.

● (1255)

[*English*]

The Chair: Madame Sinclair-Desgagné, that's the time.

[*Translation*]

Ms. Nathalie Sinclair-Desgagné: I have a quick question for you.

When do you expect a future study to take into account physical risks?

[*English*]

The Chair: Be very quick.

Ms. Carolyn Rogers: We're working on it now. We'd be happy to give you a more detailed briefing on this.

[*Translation*]

The Chair: Thank you.

[*English*]

Our final questioner for today's session will be from the NDP.

MP Blaikie, you've got the floor for the next three minutes or so.

Mr. Daniel Blaikie: One of the things I appreciate about this chair is that he always saves the best for last.

We've talked about a number of different factors today, whether it's COVID, the war or climate change that has had an impact on inflation. We've talked about some domestic causes such as perhaps price-gouging in the corporate sector, which I think has been well documented by folks at Canadians for Tax Fairness and the Canadian Centre for Policy Alternatives. There's clearly a lot of conjecture, and we've heard some of it today, about the role of government on fiscal policy and inflation and perhaps some calls that were made at the Bank of Canada on the monetary policy question and “what if” scenarios that have come up.

If we rewind to any time prior to October 2021, a big part of that narrative from certain folks in Parliament was that pandemic benefits, particularly CERB and the CRB, were driving inflation. I mean, let's be honest: The largest share of government spending through the pandemic was on direct income support to Canadians. That's what we're talking about when we talk about fiscal policy. I think it was implicit, clearly, and sometimes explicit that the line of that argument was to say that if pandemic income supports were removed from the equation, you would see a slowing down of inflation now.

The pandemic benefit programs were all but completely cancelled at the end of October 2021. The programs that were put in place in this Parliament were quite a lot less. They were harder to access. They delivered less benefit to Canadians through the omicron lockdown than their predecessors did in previous waves, yet inflation spiked and has been doing so ever since the elimination of the benefit. I'm certainly not implying any kind of causal or even correlative link between the elimination of those programs and inflation, but it seems pretty clear to me that pandemic benefit income support was not a significant driver of inflation or we would have seen some kind of relief in inflation, had those programs not been there.

There are still people who are in significant distress, not because of lockdowns explicitly, but I think of people in the travel and tourism industry, specifically independent travel advisers. I think of people in arts and culture who, while venues are open, just haven't seen the same number of people coming back. In some cases they have, but in others they haven't.

I wonder if you have some reflections with hindsight on pandemic benefit programs and some thoughts about where there might be a need for ongoing support within certain important aspects of our economy like travel and tourism that we want to see come back. In a tight labour market, we don't want to see all those people convert to another area of the economy, because those are skills and expertise that won't be available to Canadian businesses as those industries rebound, which hasn't yet happened to the extent that we might like to see but is no doubt coming.

I wonder if you might provide some reflections on that for the committee.

Mr. Tiff Macklem: You've packed a lot in there.

I think I've been very clear about our mandate and focus. I'm going to leave it to the Parliamentary Budget Officer and other bodies to assess the government's pandemic response. I'm very focused on the response of monetary policy, the need now with an economy that is moving into excess demand to normalize monetary policy reasonably quickly.

I know the words get overused, but we've never been through anything like this. We weren't going to get everything right. At the Bank of Canada, I think we've gotten more things right than we've gotten wrong, but there have been some surprises. We're addressing those and I certainly hope that in the fullness of time, when we look back on this, we will have had strong recovery with inflation coming back to target, we'll have an economy that's well balanced and growing well, and we'll have prosperity in this country.

I do think it could have been so much worse. The collective response has taken a bad situation and made the best of it, but we're not entirely through this. We have some more work to do and we're very aware of that.

● (1300)

The Chair: Thank you, MP Blaikie.

On that note, MP Blaikie—the best for last—I want to thank Governor Tiff Macklem and our senior deputy governor Carolyn Rogers. The members had many questions and you answered them in a very fulsome way, with a great amount of detail and perspective. We thank you for that.

On behalf of our finance committee, the clerk, the analysts, the interpreters and everyone who's here, thank you very much. We really appreciate it. Have a great day.

Mr. Tiff Macklem: It's a pleasure. We appreciate the committee holding us to account, so thank you.

The Chair: Thank you.

The meeting is adjourned.