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Chair

Mr. James Rajotte

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● (0845)

[*English*]

The Chair (Mr. James Rajotte (Edmonton—Leduc, CPC)): Thank you, merci beaucoup.

I call to order meeting number 128 of the Standing Committee on Finance.

Colleagues, just before we get to our special guest this morning, I just want to inform you—I believe you all know—that with respect to our study on income inequality, a motion was adopted in the House of Commons. I'll just read it for your information. By unanimous consent it was ordered:

> That, in relation to its study on income inequality, the Standing Committee on Finance be authorized to continue its deliberations beyond Thursday, June 13, 2013, and to present its report no later than Thursday, October 31, 2013.

This reflects the will of this committee as well. Thank you.

Our second order of business today, pursuant to Standing Orders 110 and 111, is the order in council appointment of Stephen S. Poloz to the position of Governor of the Bank of Canada, referred to the committee on Monday, May 27, 2013.

Governor, I want to welcome you to the committee for the very first time. I congratulate you, on behalf of all committee members, on your appointment. With your predecessor, Mark Carney, we always had very interesting dialogues. We look forward to a very interesting dialogue with you here this morning.

At this time, I'll allow you to begin with an opening statement, and then we'll have questions from members.

Mr. Stephen S. Poloz (Governor, Bank of Canada): Thank you very much, Chair. It's a pleasure to be here.

Good morning. *Bonjour, tout le monde*.

The Bank of Canada's commitment to Canadians is to promote the economic and financial welfare of the country. One way that we do this is to communicate our objectives openly and effectively and stand accountable for our actions. Thank you very much for this opportunity to come before you to share the bank's perspective.

Kindly note that today is day four on the job for me. It has been a busy three days. I trust you'll forgive me if there are any details, though, that I haven't yet become familiar with. But that said, I look forward to hearing your views and taking your questions, and I'll answer them to the best of my ability.

The common denominator that ties together all the bank's work is confidence. Through our actions and our words, what the Bank of Canada delivers is, first, confidence in our currency; secondly, confidence in our role as fiscal agent for the federal government; thirdly, confidence in our banking system; and fourth, confidence in the value of money.

[*Translation*]

This is familiar ground to all of us here today. I don't propose to delve into the details of the bank's functions. Rather, I will discuss the current context in which we are operating and how that is influencing the bank's work of delivering confidence.

It is now almost six years since the start of the global financial crisis. Given the near-collapse of the global financial system and the dramatic plunge in global demand, it's perhaps no surprise that we haven't yet returned to normal economic conditions.

The global economy continues to struggle. Most advanced economies are still facing credit stresses and record-low interest rates. Many central banks continue to use unconventional means to provide stimulus, and governments are doing everything they can to manage their respective debt situations.

[*English*]

Clearly, the global economy is still in recovery. Global economic activity is expected to grow modestly this year before strengthening over the following two years. But this is not a recovery in the usual sense; it's closer to a post-war reconstruction. It will require sustained and focused efforts to rebuild global economic potential.

Allow me to talk about how, in this context, the Bank of Canada delivers confidence. Let me start with confidence in our currency, which for many Canadians is our most tangible work. Every banknote in the wallets of Canadians is the product of specialized and sophisticated expertise. We have nearly 200 people at the bank, physicists, chemists, engineers, and other experts, who design, test, and distribute banknotes across Canada. We also communicate with retailers, financial institutions, and the public, and we work with law enforcement to fight counterfeiting.

The stakes are high when it comes to counterfeiting, not only in direct losses to Canadians but also the loss of confidence it creates in the use of banknotes.

The challenge of counterfeiting is significant. There was a time in 2004, for example, when counterfeiting in Canada was at an historic peak and very high by international standards. I'm sure many of you will remember seeing the signs posted in stores saying $100 or $50 banknotes were not accepted.

The Bank of Canada introduced enhanced security features and worked closely with law enforcement agencies, the RCMP, and the courts, as well as financial institutions and retailers, to bring those counterfeiting rates down, and we succeeded. Even before the introduction of our new polymer banknotes, counterfeiting rates had been reduced by 90%, but it's important to remember that staying ahead of counterfeiters is a constant challenge and we must always be proactive.

That's why the bank launched a new series of polymer banknotes that are safer, cheaper, and greener. They're safer because of sophisticated security features that make these notes very hard to counterfeit and easier to verify. They're cheaper because they last at least two-and-a-half times longer than paper-based notes. This means that fewer notes will need to be printed, making the series more economical. And they're greener, because over the life of the series fewer notes produced means fewer notes transported, and when they do need to be replaced the notes will be recycled right here in Canada. With these new notes, Canadians can have full confidence in their currency.

The second area of our focus is much less visible to most Canadians. As the fiscal agent of the federal government, the Bank of Canada provides advice and administers the government's debt and its reserves and demonstrates global leadership in these realms.

Innovative work is being done, for example, to reduce the reliance on external credit-rating agencies in the management of the government's assets and liabilities. There's a lot of money at stake. In 2012, the bank managed Government of Canada daily cash balances averaging about $17 billion. We also managed on behalf of the government, official international reserves amounting to about $69 billion.

The third area where the bank delivers confidence is in our financial system. As with any plumbing system, we tend to take notice only when things go wrong. Through the crisis and since, the bank's work has meant that the resilience of Canada's payment clearing and settlement system has been maintained at a very high level, ensuring that Canadians can have confidence that the economy is supported by solid financial market infrastructures.

● (0850)

[*Translation*]

Financial stability at home is necessary, of course, but not sufficient. The crisis made it abundantly clear that the global financial system needed remodeling and the Bank of Canada has been at the forefront of global reform work. Canada has also made good on our G20 commitments. Among other reforms, we have put in place Basel III capital standards ahead of schedule. We have made significant strides on other market infrastructure reforms, which we can address in detail during our discussion.

These are real accomplishments, and our financial system is stronger as a result. But we must not lose momentum, here in Canada or on the international stage. More work is required to end the phenomenon of institutions that are too big to fail, including recovery and resolution plans for banks. And countries need to address the issue of shadow banking to ensure that systemically important financial institutions operating outside the perimeter of regulation come broadly into line with their regulated counterparts.

● (0855)

[*English*]

Finally, confidence is clearly important for the conduct of monetary policy. Monetary policy in Canada is supported by a governance structure that instills confidence and ensures that Canadians, through their government, have a say in setting the monetary policy framework. Importantly, the structure also ensures the independence of the central bank to make the right policy decisions to achieve our inflation target.

Canada's monetary policy framework is a good one. After a tremendous amount of research, Canada adopted an inflation-targeting regime in 1991. Since 1995 the target has been 2%. We recognized at a very early stage that a commitment to hold inflation absolutely steady at 2% was unrealistic. Shocks to the economy must be taken into account, so the framework was designed to keep total CPI inflation at the 2% midpoint of a target range of 1% to 3% over the medium term.

It bears mentioning that this target is symmetrical: we care just as much about inflation falling below the target as we do about its rising above it. The bank raises or lowers its policy interest rate as appropriate in order to achieve the target, typically within a horizon of six to eight quarters. That's about the time it normally takes for policy actions to work their way through the economy and have their full effect on inflation.

Over the past couple of decades the average rate of inflation has been very close to target. Even during the global economic and financial crisis, our commitment did not waiver. The inflation target is sacrosanct to us and has become a credible anchor for the inflation expectations of Canadians.

A key component of the Bank of Canada's inflation-targeting framework is a flexible exchange rate. While the exchange rate is influenced by such variables as commodity prices, relative inflation rates, and relative interest rates, its value is determined in currency markets.

The credibility earned by the bank over the past 20 years allows us to take advantage of the flexibility inherent in this framework with respect to the amount of time it takes to return inflation to target. The recent turmoil tested the limits of our flexible inflation-targeting framework. Nonetheless, the inflation expectations of Canadians remain well anchored, proving that our framework is secure and working. But it also informs us that we need to validate those expectations to maintain our credibility.

This brings me to a discussion of the domestic context. The severity of the global economic and financial crisis meant that the recession it triggered in Canada was different from any other post-war recession. Canada experienced a particularly deep contraction of investment and exports, as business confidence plummeted along with global demand.

In the immediate aftermath of the crisis, stimulative monetary and fiscal policies proved highly effective in supporting robust growth in domestic demand, particularly household expenditures, which grew to record levels. Yet, as effective as it has been, with domestic demand now slowing, the limits of this growth model are clear.

What's less clear is the rebuilding process that underlies the necessary rotation of growth toward net exports and business investment. While the Canadian economy as a whole has recovered from the recession, thanks to domestic demand, the depth and duration of the global recession delivered a direct, sharp blow to Canadian businesses.

In many cases, temporary plant shutdowns were not sufficient to match the fall in demand. Some firms permanently downsized their operations. Others simply closed their doors. Large job losses resulted. In effect, the recession caused a significant structural change in the Canadian economy. The level of our country's productive capacity—in other words, its potential—dropped, as the bank noted in April 2009. Standard macroeconomic models don't really capture these dynamics.

Just as the financial crisis triggered an atypical recession, the recovery cycle is also unusual. The rotation of demand will require more than just the ramping up of production. The sequence we can anticipate is the following: foreign demand will recover; our exports will strengthen further; business confidence will improve; companies will invest to increase capacity; and existing companies will expand and new ones will be created.

In short, what we need to see is the reconstruction of Canada's economic potential and a return to self-sustaining, self-generating growth.

The sequence may already be under way. We are now seeing signs of recovery in some important external markets, notably the United States and Japan, and there's continued growth in emerging market economies. The bank expects that the gathering momentum in foreign demand should help lift the confidence of Canada's exporters. This is critical for Canadian firms to boost their investment to expand their productive capacity.

To conclude, the bank has a role to play in nurturing that process to the extent possible within the confines of our inflation-targeting framework. There is no conflict between nurturing this and our need to get inflation up to the 2% target.

● (0900)

[*Translation*]

In monetary policy, actions are critically important, but words, too, matter a great deal. We can bolster confidence by explaining the forces at work in our economy, our projections for what's ahead, and our monetary policy response. And we help nurture confidence by listening to businesses, to labour groups, and to industry associations in order to expand our understanding of what's happening in the real economy.

[*English*]

We must always remember that beneath our economic and financial statistics and analysis are real people making real decisions that can lead to bad outcomes as well as good ones. Those decisions are very hard to make at any time, but when uncertainty is high and confidence has not been fully restored, they can be even more difficult. A lack of confidence can mean that such decisions are simply postponed and opportunities are lost.

To help engender confidence, an active engagement with Canadians must be a cornerstone of the policy of the Bank of Canada, not least of which is a continuing dialogue with this committee.

With that, I thank you for listening and I would be pleased to take your questions.

Merci.

The Chair: Thank you very much, Governor, for your opening statement.

We'll begin members questions with Ms. Nash, please.

Ms. Peggy Nash (Parkdale—High Park, NDP): Thank you, Mr. Chair.

Good morning, Governor. Welcome to the finance committee, and congratulations on your appointment.

I'd like to question you on a couple of different topics. You have spoken a lot in your remarks this morning about confidence, confidence in our financial sector, confidence in our economy, confidence in the bank. I know you will agree with me that the Bank of Canada should be completely independent in its execution of monetary policy.

In the finance committee we've been dealing with the government's omnibus legislation, Bill C-60, which would give the government veto power over hiring decisions. It would involve the government in labour relations at crown corporations, including the Bank of Canada.

My question is, do you think this could in any way compromise the independence of the bank and, therefore, compromise the confidence that Canadians have in the Bank of Canada and its complete independence from the government?

Mr. Stephen S. Poloz: Thank you for your congratulations, and for your question.

The short answer to that question is no. Monetary policy independence is enshrined. It has been since central banks were first created; that's why they were created. The bank's operational independence for monetary policy is legally enshrined in the Bank of Canada Act, well established in practice.

On the administrative side of the bank, it's not that different. Of course, we have lots of legislative measures that already apply to us, the Canada Labour Code, the Human Rights Act, etc. I think we're generally seen as team players. That is, we consider ourselves part of the family of the public service and our budgets tend to be well-aligned with federal government guidance, etc., and our compensation arrangements are also in line. So I see quite a clean separation between, if you like, administrative independence versus monetary policy independence.

● (0905)

Ms. Peggy Nash: Do you think it would be desirable specifically to exempt the Bank of Canada from this provision on labour relations and the control of the government over labour relations at crown corporations, as provided for in Bill C-60?

Mr. Stephen S. Poloz: The Bank of Canada is answerable to Parliament in the same way as any other government agency, so personally, I don't really see a need for that sort of exemption. As I said, I think it is aligned with the way we behave already. We have an oversight board from the private sector, which gives us great guidance along those lines. So we don't expect any significant impact from this. It's obviously very clearly separable from operational independence so far as monetary policy itself is concerned.

Ms. Peggy Nash: Okay, thank you.

In April your predecessor, Governor Carney, pointed to household debt as a major domestic threat to our economy. He said it was perhaps the major threat to our economy. I say this at a time when the OECD indicates that Canada has, perhaps, the third most overvalued housing market in the world. The previous governor went so far as to say that current levels of household debt can strain the bank's ability to do more to advance our economic recovery. While there isn't a lot more the bank can do in this regard, do you agree with that assessment in general?

Mr. Stephen S. Poloz: In general I'd say I do agree with that. Given the circumstances we were faced with, we were very fortunate that we had the capacity for households to in effect step up and expand their spending. As I said in my opening remarks, that is what gave us a buffer or cushion underneath the global contraction that we faced.

As the healing process continues globally, we should see that transfer of momentum as we reach full balance, and that would give us a period in which households, in effect, rebuild their balance sheets and become in a stronger financial position.

Ms. Peggy Nash: I'm afraid my time is up. Thank you.

The Chair: Thank you, Ms. Nash.

We'll go to Mr. Jean, please, for your round.

Mr. Brian Jean (Fort McMurray—Athabasca, CPC): Thank you, Mr. Chair.

And thank you and congratulations as well.

On the Finance Canada website, it says:

> This has been an extremely thorough process as we sought the best candidates from around the world.

That's from Mr. Flaherty.

Reading that, you must be quite honoured to be one of the best of the best in the world, at least considered so by Minister Flaherty. I looked through your resumé. You have a Ph.D., a Masters, a Honours BA in economics, and, in fact, you spent a considerable time at Export Development Canada, 14 years it looks like, as senior VP, chief economist, CEO and president. Some people may not realize it, but you also spent a lot of time at the bank before, some 14 years, in various capacities.

You've seen the inner workings of Export Development Canada, as well as the Bank of Canada, is that fair to say?

Mr. Stephen S. Poloz: That is fair to say. I'm a lot older than I look.

Some hon. members: Oh, oh!

Mr. Brian Jean: You're doing well on that.

I thought about it, and, for the most part, I couldn't think of anybody better suited for the job. Export Canada is what our economy is based upon, either insurance or financial services, or supplier and project financing. But truth be told, our economy is so contingent on the success of our exports that nothing could be better as a background, in my opinion, than the ability to concentrate on our economy.

Would you not agree with that?

Mr. Stephen S. Poloz: I certainly would.

Mr. Brian Jean: The last Bank of Canada governor was from northern Canada. You're not from "Edmonchuk" or some place like that, are you?

Mr. Stephen S. Poloz: No, I am from Oshawa.

Mr. Brian Jean: Okay.

The reason I ask is that you're quite a success story. A third-generation Ukrainian, your parents came here, obviously, with very little and you rose to the very top of an industry that is the top and most important in Canada, in my opinion, and you've done so successfully as the son of immigrants.

My point is that we're doing an income inequality study right now, or an "equality of opportunity" study I like to call it, and you are an example, I would suggest, of how successful one can be in Canada, through hard work, etc.

What I'd ask you at this stage, and I know it's not very normal, but what do you attribute your success to and your rise over a period of 28 years to the most senior level of what I would consider to be the most important job in the country, or at least one of the three?

● (0910)

Mr. Stephen S. Poloz: Well, thank you for your question. It is an unusual one. It's caught me a little off guard, I'll admit.

Let me say that I worked very hard—and I suppose that culture of hard work I do owe to my parents, who worked very hard and always thought that if I worked hard and did well in school, I could have a better life and create a better life for my children.

Somewhere along the way, I came to realize that public service was an important driver for me, that the wish to do something for the common good is something that really fills my bucket. I discovered it most when I was in the private sector because I thought it was lacking. So I was delighted to have the opportunity to come back to the public sector back in 1999.

Anyway, long, perhaps too long, that combination somehow of hard work—and I have to admit, I got lucky a few times.... In 1978, one of my professors at Queen's thought, “Oh, that's interesting stuff you're doing on money; I bet the bank would be interested”. He called the deputy governor at the time, George Freeman, and told him about this. Overnight, I had a summer job in the monetary department at the Bank of Canada, and that's where a passion was born. So that was in 1978.

Mr. Brian Jean: What do you consider to be the best part of your background, education, and work experience suiting you for this job? I know you were chief economist, for instance, at Export Development Canada. Would you say that, combined with something else, would be the best part of your resumé, that helps you with what you're going to do?

Mr. Stephen S. Poloz: I would describe it more as a tool kit.

If you're a Sunday hobbyist and you have only half the tools you need, you end up going over to Home Depot to get something extra to finish that job. Along the way, you collect a tool kit. It begins with an intense interest in things monetary—which is what I did all of my research work on during my student days—which was, clearly, why at that time I was preparing myself to come to the Bank of Canada for a permanent position. That chief economist experience, however, puts economics into that tool kit phase, as opposed to more of a passion or religion phase, because there's so much more going on. Then, the evolution to the EDC has given me much more of a grounding in the real business community in Canada, which gives you a whole other way to think about those issues—highly complementary—and so I find then that the tool kit feels full.

The Chair: Thank you very much.

Thank you, Mr. Jean.

We'll go to Mr. Brison, please.

Hon. Scott Brison (Kings—Hants, Lib.): Thank you, Mr. Chair.

Welcome, Governor.

EDC's global export forecast for spring of 2013 suggested that exports will be a key driver for Canadian growth over the next two years and that “a softer loonie” will help. According to the Bank of Canada's recent monetary policy report, the loonie is predicted to stay near 98¢ U.S. in the near term. Do you believe the loonie is overvalued today, the Canadian dollar?

Mr. Stephen S. Poloz: Like my predecessors, I will not offer a running commentary on the Canadian dollar, where it is and where it should be. I would say though that the EDC forecast is run through a process that I very much respect and find helpful, a very wide-ranging analysis that gives us that kind of prediction that exports really are gathering momentum. That's a very good thing for Canada. The quote that you offer, which is that a softer loonie will help, is a very marginal kind of addition.

In fact if you talked to a company, they'd pretty quickly tell you that their contract is with a foreign, say U.S., buyer. It's a U.S.-dollar contract. If the Canadian dollar moves during that contract, exports don't change, and the price that the person in the U.S. pays doesn't change. The only thing that changes is how much money the company gets. So it affects the profit margin.

● (0915)

Hon. Scott Brison: Governor Carney welcomed the move to tighten the rules from 40-year mortgages to 25-year mortgages. He called the move, when he was before this committee, desirable and prudent. Would you agree with Governor Carney?

Mr. Stephen S. Poloz: In the conditions we found ourselves in, I would absolutely. I have only so many tools in the tool kit. In fact, at the Bank of Canada we really have only one, so you can't control everything. Fortunately there's a bigger team that's concerned with financial stability. So in the context, I believe those were the right changes to make.

Hon. Scott Brison: Would you agree logically that it was imprudent to loosen the rules and allow 40-year mortgages with no down payment in 2006? You have opined on one. I assume you're prepared to opine on the other.

Mr. Stephen S. Poloz: I did preface my remarks by saying “in the conditions we found ourselves in”. That is something that I think you would look at on a continuous basis depending on the context in which we found ourselves. Certainly for what we see right now and for the foreseeable future, this is the appropriate setting.

Hon. Scott Brison: Earlier this year, Moody's downgraded six of Canada's biggest banks citing concerns over consumer debt levels and inflated housing prices. Was this an overreaction?

Mr. Stephen S. Poloz: I won't comment on the methodologies that credit-rating agencies use. But it is their job, at least—people pay them for this—to look out and see whether the fundamentals of an institution are strengthening or easing back. In the kind of environment we find ourselves, any analyst would ask those questions. How they reached the conclusion that it requires a downgrade is not part of my tool kit.

Hon. Scott Brison: What are the biggest risks facing Canadian banks today?

Mr. Stephen S. Poloz: I think the risks that a Canadian bank would face today would be similar to the ones that we face. We believe that the world economy is strengthening. All the signs that we look at suggest that countries are either at bottom or strengthening, which is—

Hon. Scott Brison: Would household debt be the biggest risk?

Mr. Stephen S. Poloz: Household debt certainly makes the list of risks that it would face, and of course knowing that—

The Chair: You have one minute.

Hon. Scott Brison: Would it make the list of risks or would it perhaps be one of the most important risks?

Mr. Stephen S. Poloz: It is obviously an important risk. I'm not going to rank my risks but it is an important risk. It is a risk because we don't think the current situation will last forever. At some point, interest rates are going to rise to a more normal level, and at that time, I hope the people who have those mortgages are fully prepared for that. But since we don't know if they're fully prepared for that, an analyst might identify that as a risk to a bank. That's where I would stop.

The Chair: Thank you.

Thank you, Mr. Brison.

We'll go to Ms. McLeod, please.

Mrs. Cathy McLeod (Kamloops—Thompson—Cariboo, CPC): Thank you, Mr. Chair.

I, too, would like to congratulate you, Governor, on your new role. Since it's our first opportunity to meet and get to know you, I'd like to follow up on some of the questions that Mr. Jean was exploring. You talked about your time with EDC. I understand that you joined them back in 1999 as vice-president and chief economist. You were then named senior vice-president, corporate affairs, in 2004, and you have been president and CEO since 2011.

Can you talk a little bit about what those roles entailed and how they provided some experience that will support you in your new role as Governor of the Bank of Canada, given the challenging times we face, as you articulated so clearly in your opening comments?

Mr. Stephen S. Poloz: Thank you very much for your question.

I think it's fairly evident that being a chief economist of any kind of a financial institution is a helpful piece of experience to have. In the case of EDC, it's primarily focused on international economies and how that feeds back to the Canadian export community, but in any case, it still requires a breadth of understanding of monetary policy issues as well.

Moving on from that, corporate affairs involved planning, government relations, those kinds of things, which are important for my community in Ottawa—and then I moved on to one you didn't mention, which was that during the crisis I was the head of EDC's lending operations.

In a given year, EDC would normally lend something like $12 billion to $14 billion or 800 to 1,000 individual loans. Most of them are smaller loans. Some of them, of course, are larger loans. During the crisis, in the budget that year we were asked to move out into the domestic market to complement the offering from Canadian banks in order to offset any credit crunch symptoms that were emerging.

So during the crisis, that's where I was. I was a very busy banker. We would have companies that had half as much credit as they needed because one of their lenders—often a third-tier bank—had decided it could not renew its credit facility. So in that situation we did a lot more lending, always in partnership with the Canadian banks. That experience gave me two things: it gave me an intimate conversation with a lot of large and very small Canadian companies, so I understood it through their lens; and, second, I got to know their bankers and worked with their bankers to get credit packages that would get them through the crisis period and out the other side.

A lot of great companies were saved during that process.

So that all adds up, I think, to a pretty diverse tool kit, as I was saying to Mr. Jean.

● (0920)

Mrs. Cathy McLeod: Great. And, of course, the Governor of the Bank of Canada is familiar territory. I noted that you had 14 years of experience with the bank, where you played a number of important roles, including being the bank's representative at the International Monetary Fund in Washington.

I'd like you to focus on your time with the banks, specifically regarding your work related to the monetary policy, and tell us a little bit more about the work you've done in this area, and again how that's going to guide you in your new role.

Mr. Stephen S. Poloz: Thank you.

Yes, when I arrived at the bank in 1981, for the second time, for my full-time job, we didn't have inflation targets then. We had money targets and they were posing some difficulties at the time, and since my thesis had been on exactly that, I was able to.... I was hoping to save the money targets, but in fact I just proved that they were unreliable, *en passant*, and so as a result Governor Bouey dropped that target.

What happened next was a big phase of heavy research for the new holy grail of monetary policy—and just coincidentally, Mr. Macklem was my colleague through that time. He came and joined the team, I think, in 1984, and we worked together on this, looking at alternatives. Through that decade, we looked at a lot of things, as I said, but in the end we ended up with inflation targets as the easiest thing to explain, the most direct thing to go after. It was during that phase that we decided that a two-percentage point margin would give us the zone of manoeuvre that we needed, and so on.

Those were formative years for me. I left the bank in 1995, just after the actual.... We've had the targets in place since 1991. By 1995 we were down to 2% as the target, which is where we are today. So I was there during those formative years.

Thank you.

The Chair: Thank you.

Thank you, Ms. McLeod.

[*Translation*]

You have the floor, Mr. Caron.

Mr. Guy Caron (Rimouski-Neigette—Témiscouata—Les Basques, NDP): Thank you, Mr. Chair.

Welcome, Governor Poloz.

In 2005, before the financial crisis, you gave a speech to the Board of Trade of Metropolitan Montreal in which you said the following:

> Accordingly, Canadian companies are well-positioned to take advantage of a solid global economy, good domestic fundamentals, low financing costs and a strong Canadian dollar, to elevate their productivity onto a whole new level. In effect, we are suggesting that they will increasingly use international trade as a tool of supply, a tool that boosts efficiency…

Of course, that was before the financial crisis. Since then, we have seen that the exchange rate and its equivalent purchasing power did not follow suit. Central banks in other countries that were affected by the economic crisis bought massive quantities of our currency and our bonds, which created an upward pressure on our dollar. As a result, companies did not invest to the extent we would have liked.

What do you feel is the importance of the strength of the Canadian dollar in the crisis of Canadian productivity?

Will the transition that seems to be getting started in the economy at the moment, after the crisis, be the motivation for companies to invest more?

● (0925)

Mr. Stephen S. Poloz: Thank you for the question.

In that context, it is clear that Canadian companies are going to face a major challenge. The fact that the dollar is a little high increases the size of that challenge.

In terms of productivity, we can see that there are some excellent examples when we talk to business representatives individually. But it is not clear in the data we have at our disposal. It is a bit of a mystery. I suppose there are some problems in comparing and accumulating information.

Whatever the reason, it is clear that our productivity is weaker than we would like. The fact that the dollar is high might let businesses buy machinery and equipment at lower-than-normal prices. But that is a trend that we are not really seeing at the moment. We are still waiting for the time when business confidence is high enough for them to decide to make those kinds of purchases. The situation varies from business to business. But it is clear that the global economic uncertainty is making it very difficult to decide whether it is the time to make investments by buying something very expensive.

Personally, I am confident that there will be a gradual progression. But it is not generally clear at the moment.

Mr. Guy Caron: There has always been a large gap in productivity between Canada and the United States. Reducing that gap was actually one of the goals that prompted us to sign NAFTA. But the gap has not shrunk. On the contrary, it has grown.

What do you see as the reasons why we have not been able to find a solution to the productivity issue? You say that, at a microeconomic level, there seem to be signs of progress. But that is not visible on a macroeconomic level.

According to the Bank of Canada, and in your opinion as its new governor, how can we get the tools we need to increase productivity?

Mr. Stephen S. Poloz: Thank you for the question.

The most important factor—and really the only one that the Bank of Canada can provide—is an environment that keeps prices stable. By that I mean a predictable environment, with minimal uncertainty, so that businesses can plan ahead.

However, as I have already mentioned, the issue of productivity is very complex and varies from business to business. For example, how do we measure the productivity of a company whose scope is international? Do we measure only the Canadian part or all or it?

In Canada today, what Canadian businesses sell equals our exports. That is to say that there is a second Canadian economy in the world that is not directly included in the statistics. These are operations—including manufacturing—that are part of what businesses do and that are really very productive.

There is also research, development, management and so on in Canada that is very difficult to measure in terms of productivity. Is the productivity of a company like Bombardier Aerospace comparable to Boeing's, for example? Not really; it is like comparing apples to oranges. Comparison is not possible.

This is not to say that no gap exists. It does. The question deals with our long-term performance and it is a very complex one. I cannot answer it completely today.

● (0930)

The Chair: Thank you, Mr. Caron.

[*English*]

Mr. Adler, please. It's your round.

Mr. Mark Adler (York Centre, CPC): Thank you, Mr. Chair.

I want to welcome the new governor to the finance committee.

Congratulations on your appointment, Mr. Poloz.

I do want to pursue some of the remarks you made in your statement, particularly where you say that the global economy continues to struggle and that there won't be recovery in the usual sense, but that it's more like a post-war reconstruction.

I want to ask you to expand on that. What in your mind are the short- and long-term challenges facing the Canadian economy right now?

Mr. Stephen S. Poloz: Thank you. It's a pleasure to be here.

Thanks as well for the opportunity to elaborate. I think this is a very important part of the story.

I referred to it as a post-war reconstruction to capture the notion I have in mind, that the trauma that we've been through was not like a typical cycle in our economics textbooks at all. It was much deeper. It was caused by a financial crisis as opposed to a simple slowdown. It was longer. It therefore interacted with companies' banks. If you have a nine-month recession, of course your bank will let you ride the recession, but if it's a five-year recession, you're going to have to address the debt with the bank and so on. You have a very much more complex kind of story on the way down.

Part of that story was that companies simply exited. So some of the reduction in output and employment that we've seen is in that sense permanent, because the companies aren't there now.

So when we see the recovery process, then, it's not just a matter of expanding your output back to normal. For many companies it is, but for the companies that are no longer there or that have downsized significantly, it's a matter of their re-expanding, which requires a significant new investment, or being created out of thin air, which of course is an even more risky proposition.

It's for that reason that confidence plays a much stronger role in this move back up than it would in a normal cycle. It's also why our models don't really give us the insight we need in order to understand that process.

At the bank, we'll be investing more energy into this, understanding this, as we climb out. In the past, talks have likened it to a post-bubble crater that we are in, which will take a long time to get out of. We in Canada have been lucky, but the world will be in the crater for a longer period.

I trust that gives you more insight into what I'm trying to say there. It's a process that we need to understand. Clearly we need to nurture it, because it will require that gradual buildup in confidence and the actual self-sustaining Schumpeterian process, if I can use that term with the member, of natural growth, of new companies, new products, etc.

Those decisions are hard to make in an uncertain environment. The confidence, therefore, plays a much bigger role than normal.

Mr. Mark Adler: Thank you.

Yes, confidence plays an important role, and I see what you're getting at here, but you're now in the monetary policy business. How do you see monetary policy playing a role in this reconstruction effort?

Mr. Stephen S. Poloz: Well, our monetary policy is designed to give the most predictable and price-stable environment in which to operate, so our key ingredient is to provide that as a playing field in which companies can make these decisions. Secondly, there's the financial stability that goes with that: the strength and resilience of the financial sector, of the financial institutions. We have a role to play as part of a broader team to give that assurance.

The rest is more of a natural healing process that I think we don't understand very well, because we've never been in this sort of setting before. It's one that we need to invest energy in understanding, both as a traditional economist would, which would be studying past episodes and so on for the insights they can deliver, but also by talking to real people about what is going on, about what they see through their lens. It's about asking a company, “What would it take, what would you need to see, before you would be ready to make this expansion?” Would it be this much of a strengthening in exports? This much? Would you need Europe to be settled down? What would be the ingredients?

Then we'd be in a position to watch that unfold and be a little more predictive about when it would come, and that will matter a lot to monetary policy.

● (0935)

The Chair: Thank you.

Thank you very much, Mr. Adler.

Mr. Rankin, please, for your round.

Mr. Murray Rankin (Victoria, NDP): Thank you, Chair.

Welcome, Governor. I appreciate your attendance.

I'll take you to some macroeconomic questions that flow out of your written remarks this morning. In your written remarks, you talk about the recession causing “a significant structural change” to our economy in talking about our country's “productive capacity” dropping. As the bank noted, in 2009 that occurred, but then you say, “Standard macroeconomic models don't really capture these dynamics.” You say then that “the financial crisis triggered an atypical recession” with an “unusual” recovery, in your words.

Then you go on to talk about a positive prediction about where our economy will go, with foreign demand recovering, increased capacity, and expanding companies and the like. However, the OECD recently reduced the estimates for Canadian economic growth. In November, it was projecting 1.8% growth for this year. It has now downgraded that to 1.4%. The OECD also reduced their prediction for growth in 2014 from 2.4% to 2.3%.

I guess my question is, given what you call the inability of “standard macroeconomic models” to capture these dynamics, how can we be confident in the predictions that you've just made this morning?

Mr. Stephen S. Poloz: Thank you for your question.

Well, I think I was careful not to make any predictions, and I think for that very reason. Of course, when we get to July 17, when we issue our monetary policy report, we will put our best numbers forward, as we did in the past MPR, which of course I was not part of.

But I think the answer to your question is that models don't become useless in this setting. What they become, though, is less useful than they usually are, as if the zone of ignorance or the margin of error is bigger. That requires us to work harder at the judgmental aspects of how we put these numbers together, which I am absolutely certain the OECD would agree with. They have done exactly the same thing.

When you do these things, then, you use the model as a way to ask the right questions, and then you use other evidence or other models to help fill in the shady parts. We already do this at the bank; I've seen enough to know that's true. So it's a robust conversation, and then we'll come in and say that in our best judgment it's this for 2013 and this for 2014.

Mr. Murray Rankin: All right.

I'd like to ask about two other areas that our committee has been working on. One is tax evasion, and then, if time permits, the other is income inequality.

On the tax evasion front, in 2010 the Bank of Canada published a work that talked about estimating the underground economy. Given that expertise, would Bank of Canada economists be able to estimate the scale of tax evasion and the use of tax havens by Canadians and Canadian corporations? If so, would that be worthwhile?

Mr. Stephen S. Poloz: Thank you.

This is a question that has always been of interest to economists in general. Of course, from a central bank's point of view almost anything like that is of interest.

However, it's of interest from the point of view of understanding how the economy is behaving better than we would know without understanding that. We'll do research on a wide range of things that appear to be peripheral to the actual decisions we make, which is not unusual, but they help us have a better feeling of confidence around those discussions.

The bank has a crack research team, it's really superb, and this has always has been one of our trademarks, if you like, of excellence in research.

This could be of interest, mainly if it were getting larger or smaller. It has a connection to the currency business, which I talked about in my opening remarks. It helps us understand whether our currency design and our program is in some way making it easier or harder, but that's really the crack in the door, if you like, the angle with which it has a direct link to us.

● (0940)

The Chair: You have about 30 seconds.

Mr. Murray Rankin: Mr. Carney, your predecessor, expressed concern about high rates of inequality in this country becoming an issue. Would you update us on any research that the Bank of Canada may have conducted on inequality?

The Chair: Just a brief response. We may have to return to the topic at another time.

Mr. Stephen S. Poloz: Of course, Mr. Chair.

I'm afraid I don't know what new research has been done on that. I would say that as a central bank we really only have a modest influence on this, which is to lay a good playing field with price stability, which gives us the best chance of having things operate, markets operate, as they should. Otherwise, it's more one of those things that is of interest but not directly applicable to the policy discussion.

The Chair: Thank you.

Thank you, Mr. Rankin.

Mr. Van Kesteren, please.

Mr. Dave Van Kesteren (Chatham-Kent—Essex, CPC): Thank you, Mr. Chair.

I'd like as well to congratulate you, Governor, on your new position.

I want to talk to you about inflation and the difficult job it is to measure inflation. What is your opinion of the method that we use, the consumer price index?

For the benefit of those who may be watching this on television, could you explain how that is measured and what today is included, and what's taken out too. And could you say if that is still the measurement we should be using.

Mr. Stephen S. Poloz: Thank you. I appreciate that question.

This business of measuring inflation is actually, as you've hinted, much harder than it looks. Probably every one of us has our own personal inflation experience. The reason that's different from person to person is that our spending patterns differ quite a lot by age group or by region, or what have you.

We begin there and ask ourselves what's the simplest and most intuitive way of coming up with something that works pretty well. I think that's a pretty good description of the CPI.

The CPI takes your typical household basket, takes a reference year and says in that year households spent 2% of their money on this, 4% on that, on all these items and so on. Then, of course, it tracks the sale prices of each of those items and then takes a weighted average of all of those things, builds it into an index and asks how much it went up since the last time we looked at ti. That's our measure of inflation.

That's complicated enough, but economists can always complicate something further. There are many other more sophisticated ways of doing this, but the good news for us is that we don't need to go into them because they result in little differences here and there at certain times, but on average they all tell us roughly the same thing. That's what makes the CPI very attractive because regular folks understand what it is. They understand when they're buying the milk that it's going into the CPI and it's recognizable. If we say that's the thing we're going to target, they understand that and it anchors their expectations. That's the combination we're looking for.

Mr. Dave Van Kesteren: Thank you.

I want to go to something that you remarked about in your opening statement, and that's the near collapse. I think sometimes we forget about this—it has been six years since. I know that our finance minister has on a number of occasions referred to it as our having been on the brink, that not only were we on the brink but the world was on the brink. The fact of the matter is that we are very much dependent on what happens in the world, that happens elsewhere will affect Canada as well.

With that in mind, would you maybe comment on how critical it is, now that we are beginning to move forward and climb out of that situation, to pursue new trade deals and why it's so important to diversify and find new markets?

Mr. Stephen S. Poloz: Thank you.

That is a great point. The preamble is exactly right. The world economy and the financial system were clearly on the brink and we're very fortunate that there was a such a well-coordinated—dare I say orchestrated—response that everyone participated in, because the downside could have been much bigger.

In any case, we continue to heal from that process, and in some cases the adjustments that are necessary were put off, so it's being stretched out. But I've often said that if you had six or seven years to build up that bubble—like, say, from about 2001 to 2007—the crater is going to be of a similar magnitude. So we have some time still to go, especially since we're stretching out some of the adjustments.

In that context, the world has not sat still. What has happened is that emerging markets or developing markets have actually fared quite well and they continue to grow.

I would ask you to think about how the world would look if there were people living on every planet in the solar system. Where would all the trade be happening? I'll give you the answer. The big trade flows would be between Jupiter and Saturn, the two really big places that are close to each other and would be trading with each other. We, on earth, would be sitting here wondering why we couldn't get more of that. That's the kind of world that will emerge over the next five years. We call that south-south trade.

The only way for Canada to be able to grow with the world, as a small open economy, will be to increase its reach to those markets. We see it in EDC's data that companies are doing so. Trade deals are a fantastic way to pave that road.

● (0945)

The Chair: Thank you.

Thank you, Mr. Van Kesteren.

[*Translation*]

Mr. Côté has the floor.

Mr. Raymond Côté (Beauport—Limoilou, NDP): Thank you very much, Mr. Chair.

Thank you for your presentation, Governor Poloz.

I have to admit that some parts of your opening statement impressed me deeply. I want to talk about one of them, the Canadian context. You said: “In short, we need to see the reconstruction of Canada's economic potential, and a return to self-sustaining, self-generating growth”.

In a previous meeting, I had a discussion with your predecessor. At that time, I talked about the work that we should be doing on ourselves and I talked about my own problem with pride, the pride in not wanting to depend totally on growth in other countries or in being at the mercy of a return to global growth.

Governor, how can the Bank of Canada help us to start moving in that direction?

Mr. Stephen S. Poloz: Thank you for the question.

I ask myself the same question. Basically, I do not really know if we have to nurture the process or simply be patient. I do not know. As I mentioned, there is one major variable. That is the matter of confidence, and it cannot be measured. You can try, but you will not get a reliable answer. So we have to wait, but we can also conduct research in order to better understand the issues.

If I may say so, it is a process of trial and error, because it is something completely new, something quite unique. Models guide us to a certain extent, but we are going to have to wait and understand problems bit by bit. I do not have the answer today, but I can assure you that it is a fundamental area of research, even of my own personal research. We have to talk to companies directly to help us understand the mechanisms we must choose in order to boost confidence and to make quicker investment decisions. We are asking ourselves the same question.

Mr. Raymond Côté: Given that the crisis has been going on for several years, people's patience, meaning entrepreneurs, workers or families, is wearing thin.

I must congratulate my colleague, Mr. Adler, for not having asked you questions about your political past. But he put his finger on something that impressed me a lot. You mentioned that the global economy is still in recovery. You also said that it was somewhat like the post-war reconstruction period.

That is a very powerful image. The historian in me wants to draw parallels, even though I know it is not fair to make comparisons, and that it is not possible to do so completely. Does it mean that we have to go further with our monetary measures? In the global context, do we have to embark firmly on a more interventionist path? Of course, the United States are in a completely different position than they were right after the war.

● (0950)

Mr. Stephen S. Poloz: Perhaps it is a powerful image. For me it is a way of explaining the difference between our current situation and a previous cycle such as the one we find in the textbooks. It is very different. As economists, we use our textbook models every day. I would say that this is a kind of post-war reconstruction. We have to wait for new developments and for our potential to be rebuilt. At some points in the cycle, that will increase quicker than usual. At least, I hope that will be the case.

Specifically, we need demand from outside. That will be followed by confidence and by investment. Capacity will increase. I mentioned—

The Chair: Mr. Poloz, can I ask you to wrap up quickly?

Mr. Stephen S. Poloz: I mentioned in my remarks that, in 2009, the Bank of Canada indicated that there was a drop in production, in potential. We saw that with companies in the automobile and forestry sectors. There was about a 50% drop in capacity in forestry. If we get demand because of construction starts in the United States, we will see it open up.

The Chair: Thank you, Mr. Poloz. Thank you, Mr. Côté.

[*English*]

Ms. Glover, please, for your round.

[*Translation*]

Mrs. Shelly Glover (Saint Boniface, CPC): Thank you, Mr. Chair.

I want to welcome you too, Mr. Poloz.

I found the look back to your early years to be incredible. I feel that Canadians watching us and listening to you are going to be very happy to see who the new governor of the Bank of Canada is. Thank you; your personal and professional story is very impressive.

[*English*]

I do want to take a moment, Governor, if you would allow me, to go back to your opening statement. On page 3, you make a comment in your statement that we have made significant strides on other market infrastructure reforms, which we can address in detail during our discussion.

I'd like to give you that opportunity, if you'd like, to address what you said in your opening statement.

Mr. Stephen S. Poloz: Thank you.

[*Translation*]

Thank you for your other comments.

[*English*]

Yes, most of what we've talked about this morning has been about the economic cycle, what the crisis did to us, and what the recovery's looked like so far and what we hope it will look like as it further progresses.

On the other side of this is a global imperative that we modernize the global financial architecture. It's just like an old building: it did well and then along comes an earthquake that was totally unexpected —off the Richter scale if you like—and proved to be almost too big to handle.

The financial sector most importantly is a global marketplace, so all of this needs to be fully coordinated at the global level; hence, the activities of the Bank for International Settlements, and the FSB, which Governor Carney heads up at this point. So that gives us the opportunity to all talk about what are the needs, to agree on principles, and then everybody does the same thing, so that we get a level playing field. It's a very important ingredient.

Since then, there's been a massive strengthening in capitalization. Most countries and certainly most banks—all of our banks—are way ahead of schedule in this. So a significant increase in capitalization, an increase in liquidity requirements that go beyond this.... If you ask me if the banking system today in Canada or globally is stronger than it was back in 2007, absolutely it is. It's more resilient today than it ever has been. Still there is work to be done, and it's a very active area.

In particular, we haven't yet found a full-fledged remedy globally for the too-big-to-fail problem, which is very important. If you have an institution that is likely to fail, it is infectious, and it infects your entire system. It therefore leads authorities to do a bailout to protect the system. We saw that a few times during this crisis.

The idea then is to create an infrastructure that allows us not to have that—what we call bail-in—or resolution plans, or both. If you have a full plan of how a particular institution would be resolved if it ran into those kinds of problems, then you just tell everybody it's happening, and then it doesn't infect the rest of the system. That's a very simplistic way to summarize it. It's a very complex issue because financial systems vary a lot around the world. Again, we're looking for the level playing field where everybody can do the same thing. So it will be ongoing, but I'm very encouraged by that progress.

● (0955)

Mrs. Shelly Glover: The government has been seized with this issue. As you know, in the last budget there was talk of strengthening that. Did you think that was appropriate?

Mr. Stephen S. Poloz: Absolutely, and as I mentioned earlier on, it's fully a team effort. This is the responsibility of the Minister of Finance, not of the Bank of Canada per se. The Bank of Canada participates more as an adviser, providing deeper research, that kind of thing. We sit at the table with OSFI, with CDIC, and the ministry of Finance, as a very strong team.

Mrs. Shelly Glover: I appreciate that.

There was some talk about trade. What do you think is the challenge or barrier to engaging companies in aggressively pursuing their own ability to trade in emerging markets? Is there a challenge there that we might be able to address?

The Chair: A brief response, please, Governor.

Mr. Stephen S. Poloz: Certainly. Thank you.

I'd say the challenge is more the unknown, if anything. If you've never gone on a plane to India to sell some stuff, it can be quite a challenge. What companies have discovered is that what the big emerging markets, like India, Brazil, and China, look for is to see you at the chamber of commerce luncheon every couple of weeks and to get to know you. In other words, they want your feet on the ground.

This model that companies are adopting is having a presence and making an investment in that foreign market to get a toehold. That builds the bridge of trade. That takes more confidence and more money than simply going with a suitcase full of samples and making a sale. The trade model is becoming more challenging, more sophisticated, and more reliant on the trade deals to help cover up all those issues that come with a more complex transaction.

The Chair: Thank you.

Thank you, Ms. Glover.

Governor, I want to ask you about a report by the C.D. Howe Institute, entitled *The Dangers of an Extended Period of Low Interest Rates: Why The Bank of Canada Should Start Raising Them Now*. It's a very interesting report. It's quite persuasive. One of their statements is:

> Low interest rates have given Canadian consumers an incentive to accumulate a record proportion of household debt compared with their income, despite increasingly restrictive regulations on mortgage credit and warnings by the Bank of Canada of the dangers of excessive debt.

It also talks about the effect of low interest rates over a long period of time on pension funds and insurance companies. It talks about younger people who are investing, perhaps purchasing a home for the first time, and the effect on retired Canadians with respect to pension funds and insurance companies. It makes a pretty strong case for raising rates, at least in the short- and medium-term. I would like your reaction to that.

Mr. Stephen S. Poloz: Thank you, Chair.

By the way, that report was penned by one of my former colleagues at the Bank of Canada, Paul Masson, so I'm familiar with the work. However, it's only one side of the balance sheet that I carry in my head.

Given the circumstances we found ourselves in, as I discussed in my opening remarks, that of preserving our price-stability target and getting the Canadian economy through the crisis, this was the tool that we had available, the tool of very, very low interest rates. We know that it had the positive effects that we needed at the time, and we also knew well before this paper was put out that it has attendant consequences that accumulate in the longer term. Does "low for long", which is the phrase that we use, give us these risks? The risks that are identified there are absolutely correct. Those are the same risks we've talked about before. We have to ask ourselves if those risks are more, or less, important than the other risks we are offsetting with that policy. So it's a more complex trade-off than is implied by that analysis.

We certainly believe that as the world heals, interest rates will rise as described. That's exactly what we need. But it will be consistent with our inflation target, which is to get around 2%, so that we're back where we belong. For now, this is where we are. We are cognizant of those risks. We don't see evidence of those risks manifesting themselves in a threatening way at this stage, but they will be carefully monitored. That trade-off continues to be made as we go along.

● (1000)

The Chair: One of the main concerns, as mentioned by one of the members here, was raised in the past by Governor Carney with respect to personal household dept.

Looking at generational lessons, my grandparents' lesson was that of the Great Depression. For my parents it was paying down a mortgage at very high rates. A generational lesson for someone in their twenties today is that rates will be low for a very long period of time; therefore, it's almost prudent from their point of view to take on more dept than is prudent with rates at a higher level.

To get some further reaction to that, are you concerned about the generational lesson that's being given to young people today in their twenties and early thirties, in terms of personal debt?

Mr. Stephen S. Poloz: Thank you.

I am concerned. My concern is that we do the right things to ensure that this does not last for a generation. That is exactly what the policy is about, that the low rate, hopefully for not too long, gives you the outcomes you need to get through this crisis. Then as the world unfolds, we get back to normal. That's our outlook.

I want to emphasize that we're not alone in this. The Bank of Canada is capable of doing only one thing, which is to provide the right environment for the decisions that people, such as young people, would make in a price-stable environment, with a stable financial system. But if we are concerned about some of these risks, there are other tools, such as the mortgage adjustments that the finance minister has made. There's your team effort in action, which is very good.

I think the bank has been careful to continue to remind people that interest rates will be going up at some point. The consequence of that is that when young people are deciding to carry more debt than their parents did, let's say, at this age, they must do the arithmetic to ensure that they will be able to manage it at a higher interest rate, a more normal interest rate, let me say. In that context we believe the prudence is there, both on the lender's part and on the borrower's part and we've done our best to make sure it turns out well.

The Chair: Thank you.

We'll go back to Ms. Nash, please.

Ms. Peggy Nash: Thank you, Mr. Chair.

I want to return to the point that you stressed throughout your statement this morning, Mr. Governor, which is about confidence and confidence in our economy. Your predecessor had highlighted the over $600 billion in cash and cash-like assets on corporate balance sheets. He highlighted this as a problem. At the time he called it “dead money”. It was a concern that he was raising, because businesses saw no place to invest their money in the current business climate. So it does go to the notion of confidence in the economy and the outlook for the economy.

First of all, do you agree with Mr. Carney's assessment that this money is “dead money”? If so, how do you recommend addressing the problem? I will preface this by saying that in your statement you talked about foreign demand needing to recover as a precondition for companies to invest and expand. Is that a correct understanding of your approach?

● (1005)

Mr. Stephen S. Poloz: Thank you for the question.

As for dead money, I believe my predecessor himself has declared it resurrected. Our characterization of that is a little different. It would be that, in effect, companies in Canada have healthy balance sheets, and that's a good thing. The process that I described before will be much more difficult if foreign demand is building and our confidence gets up and we don't have the balance sheet available to do the job. Then we will have a different problem.

One of the most important ingredients to getting the investment momentum that we expect to see is having a healthy balance sheet and being ready, and being in a position to do the kind of due diligence that companies do before making a sizable investment.

Part of that due diligence would be understanding what's going on in China, what's going on in Latin America, and what's going on in Europe, and whether that is going to resolve itself. Companies will have to decide whether or not they have sufficient assurance that investment will pay off for them and that it is time to act. When uncertainty is high, they wait. In that sense a healthy balance sheet is good, but of course it's waiting to be put into action.

I find that what we're looking for—as you said, the preconditions—is emerging and we don't really know at what point it will tip the balance and we will get that. As I said, the data are sufficiently slow that it could already be occurring. Certainly the people I speak to are feeling reasonably confident. They're concerned about what's going on in Europe. They have a question mark, let's say, about China, but they're more or less ready. In that sense, I'm feeling reasonably confident, but it's a question mark and I have to admit to you that I just don't know.

Ms. Peggy Nash: At the time, both the governor and the finance minister had tried very actively to encourage business to invest in a perhaps more front-loaded way their actions. But the previous governor also was very concerned about weak export growth. I assume that as the former head of EDC, this must concern you as well. Governor Carney said this has been one of the major struggles for the economic recovery. Would you agree, and do you share that concern?

Mr. Stephen S. Poloz: Thank you.

Yes, I do. The story we're talking about—healthy balance sheets, getting ready to invest, and being confident—is not uniquely but heavily influenced in the export sector. It's in that sector where we had disproportionate damage of the type we've talked about, because it was foreign demand that did the biggest collapse. It was our best trading partner that had the biggest trauma. And it has been slow to come back.

The adjustment has taken the form of finding new growth areas to invest in—keeping interest in the U.S.; we'll never lose that as our most important trade channel. Those, as I mentioned earlier, are in places that feel a little more exotic. It takes more to get your due diligence done, and so on.

We're seeing signs that it is happening. I'm confident that it will grow from here. We'll have to just continue this dialogue, because it simply isn't happening, altogether, yet.

The Chair: Thank you.

Thank you, Ms. Nash.

We're going to go to Mr. Jean again, please.

Mr. Brian Jean: Thank you, Mr. Chair.

It's a great opportunity to be able to have two sets of questions to ask you. I certainly am impressed with the choice by the government.

But I would like to talk a bit about what's near and dear to my heart, which is the regionalization of Canada's economy based upon pockets of high employment and other pockets of low employment. I speak specifically about our export market, oil sands. I'm from Fort McMurray, so I'm very passionate about that particular issue.

I see this morning, for instance, that oil sands are discounting between $30 million and $50 million per day because of a constrained pipeline. I looked at the market this morning and I saw that LNG is about $4.16 per billion cubic feet here in North America. In Asia it is $14, almost $10 more, three times the price. And in Europe it is $11.50 per billion cubic feet per day.

We know that the low price here in North America is primarily as a result of our having the constraint of delivery mechanisms to other countries, even though there's high demand from the United States. So we have one market. How great is that risk to the Canadian economy, first of all? And how do we continue to explore ways to eliminate that risk? What can we do to take advantage of the pockets of high employment areas vis-à-vis other parts of the country?

● (1010)

Mr. Stephen S. Poloz: Thank you. There are actually lots of questions in there, so I'll do my utmost to touch on them.

First of all, let's begin with the premise that we are very lucky that we have these resources. Whenever we get to develop them and sell them to the rest of the world, up until now it has been like money in the bank. It's one of these things that may take time; however, we know it's money in the bank. So we're working on it.

I remember the days when for natural gas, we didn't have any liquefaction terminals, nor the ability to move it around. So it was a closed pipeline, North American market. It was completely divorced from global fundamentals. Now it's a little less divorced, because we can liquefy and export and so on. This shows you, again, exactly what can happen in the oil space, where if you have a constraint, you won't have an equivalence of the price here and the price out in the world.

All I can suggest is that as these infrastructures are developed in various ways, we have every reason to think that over time we become part of a truly global market. But the constraints, hopefully, will go away through time.

As to the implications for regionalization, if you like—or perhaps regional imbalances of economic activity is maybe the way to put it—I'm very heartened by the way we have adjusted to developments over the last five years.

If we cast ourselves back 20 or 30 years, it seems to me we would not have adjusted as well. It seems as though in Canada, our ability to adapt to these kinds of shocks has improved. People are more mobile. People react to these pressures, and off they go. That's great to see. It means that over time, hopefully over the next 20 years, those kinds of imbalances, regional ones, would be fewer than they had been in the past, because of those adjustments.

Bear in mind that when there is one like that, it's usually because somebody has decided that something we have is worth a lot more than it used to be. So we all benefit from that, because that's just more money coming in. And it's something worth adjusting to.

Mr. Brian Jean: If we don't solve this constraint issue with oil pipeline capacity—for instance, to another coast—do you see this as a real threat to the economy? I say this specifically because right now we have about 300,000 to 350,000 people employed directly or indirectly by the oil sands. That's somewhere between 8% and 12% of the GDP of the country, and the base is expected to triple. In essence, by 2030 we're expected to have somewhere in the neighborhood of one million people in Canada employed directly or indirectly by the oil sands.

Do you see that if we don't fix this constraint issue we are going to have an even bigger discount to United States oil prices?

The Chair: Please give just a brief response, Governor.

Mr. Stephen S. Poloz: Thank you. I can make this one really brief, because I simply don't know the answer.

You're talking here about a 30-year story. A lot can happen in that time, and while it's clear that part of that story can't come true without our also making some kind of investment in infrastructure, it obviously won't have much to do with monetary policy. It will be something we'll have to take into account in the ways you describe, when figuring out the macro-implications for Canada.

The Chair: Thank you, Mr. Jean.

We'll go to Mr. Brison, please.

Hon. Scott Brison: Governor, following on your exchange with Mr. Jean, let me ask how important commodity demand will be to the recovery of the Canadian economy.

● (1015)

Mr. Stephen S. Poloz: I suggest that it's a foundation for our growth and is likely to remain very important.

How much more or less important it becomes, I really couldn't say. What I do know is that we are still in a development phase, in countries such as China or India, where growth itself, which is high, is fairly commodity-intensive, unlike growth in our own economy, which is less so. This means that as a result we get a leveraged effect of higher growth: one more dollar's worth of growth in China has a disproportionate impact upon us, through that commodity effect—either through the price or as a result of the volume itself.

It will fuel Canada's growth as far out as you and I can see. There's lots of untapped potential in Canada.

Hon. Scott Brison: This morning you predicted that we will have an unusual recovery. You've compared it to the post-war reconstruction cycle. That one was driven by a conversion of war-time production to the manufacturing of consumer goods; that was a manufacturing-led recovery.

Why do you compare what you have just said will be a commodity-led recovery to the post-war reconstruction period, which was a manufacturing-led recovery?

Mr. Stephen S. Poloz: Thank you.

You may have stretched my metaphor a little too far.

Hon. Scott Brison: I never met a "phor" I didn't like.

Mr. Stephen S. Poloz: What I'm trying to capture in my reference to the post-war period is that there were companies that were there before and are not now. The recovery process requires the re-formation of companies and the development of brand new companies or the expansion of existing companies. This is not the same as your traditional textbook cycle. That's really all I was trying to say.

Whether it's manufacturing or commodities and so on—

Hon. Scott Brison: Do you agree, though, that the manufacturing jobs created post-war were quite different from many of the jobs being created today?

Mr. Stephen S. Poloz: That's absolutely the case, but I don't discount the manufacturing sector at all. I have many case studies that we could talk about in which the manufacturing sector is flourishing in Canada by finding exactly what the foreign customer wants and doing an efficient job of producing it.

Hon. Scott Brison: Sure.

In 2005 you referred to the Dutch disease as a debilitating illness for Canada.

Do you still believe that?

Mr. Stephen S. Poloz: That may be a bit of a quick summary of what I discussed at the time. At the time, what we were doing was identifying symptoms and wondering how long they might persist and where they might lead. Those symptoms were quite correlated with what Holland saw in that time period.

I certainly don't describe what we have today as anything remotely like that. It's actually what appears to be a permanent higher valuation on the commodities that Canada has to offer the world. It's an unambiguously good thing, and it gives us the adjustments that Mr. Jean and I were speaking of.

Hon. Scott Brison: Certainly.

You have an inspiring life story. You described one of your key breaks as being that job at the Bank of Canada early in life, as a student. You were paid for that job at that time?

Mr. Stephen S. Poloz: Yes.

Hon. Scott Brison: Yes. Well, today the phenomenon of unpaid internships has reached an unprecedented level.

As an economist, what do you believe are the potential economic consequences of this growth toward unpaid internships, and the effects on equality of opportunity? Wealthier families can afford to have their children taking these kinds of great job experiences, while poorer families require that their children take any job that pays.

Is there a threat, do you see, as an economist?

Mr. Stephen S. Poloz: Well, in reference to that—

The Chair: Can you make just a brief response, Governor, please?

Mr. Stephen S. Poloz: A brief response?

The Chair: Yes.

Mr. Stephen S. Poloz: With pleasure, Mr. Chair.

That's a very complicated question, and it's far outside the bounds of monetary policy. I would just observe that I saw it in action with my own children. The experiences they accumulated were very valuable to them once they started getting paid.

The Chair: Thank you.

Governor, I did want to follow up on one of the statements you made in your opening presentation. You talked about the United States and Japan.

Japan is a country that Governor Carney, in his last monetary policy report, and the bank's last policy report, referenced as one that we should be paying increasing attention to.

Given the fact that you did mention it in your opening statement and given the situation in recent times with our currency and other matters, can you just expand on the statements about Japan in your opening statement?

● (1020)

Mr. Stephen S. Poloz: Certainly. Thank you.

Yes, Japan is a pretty significant trading partner for Canada. It always has been. It's become habitual, in fact, for economists to say, "Oh, and Japan has continued not to grow for 20 years or so." But what seems to be happening now, and we're certainly watching this with intense interest, is that the new monetary policy there is directly aimed at breaking what I would call a logjam—people who've been stuck in deflation for most of their adult lives, people in their forties who have not purchased a home or something like that, just because of the way the market is dysfunctional there.

Moving that model forward could have significant implications for the world, including ourselves.

The Chair: So you're satisfied that they are addressing the issues with respect to their currency, their monetary policy? You're seeing greater growth there. I think you're more hopeful today than Governor Carney was at his second-last presentation before this committee.

Am I fair in characterizing it that way?

Mr. Stephen S. Poloz: Thanks for reminding me of the rest of your question, Chair, which is that, yes, of course when you change your monetary policy, as they have, one of the implications with a flexible currency is that it's very likely to depreciate. And it has.

So for other countries, one has to look at the full picture, which is that there's an exchange rate effect that may affect exporters in some way. But the most important effect will be the rise in incomes and demand from Japan, which we'll all share in—what economists call the "income effect". That's unambiguously positive for the world if Japan is a growing economy as opposed to a stagnant economy.

The Chair: Okay.

I did want to follow up on another topic, which is core CPI inflation and all-items CPI inflation. Can you just explain why the Bank of Canada uses core CPI inflation as its operational target?

Some have suggested that it's not obviously as complete a picture as all-items, and therefore the bank should look at using all-items CPI inflation in terms of its operational limits.

Mr. Stephen S. Poloz: As I was mentioning earlier, there's a wide range of possible measures of inflation in Canada. On a longer-term basis, they all kind of settle in the same sort of area, but in the short term, they can be quite different.

In particular, the CPI can be heavily influenced by major movements in, let's say, gasoline prices, or food prices. Those are the classics. We used to just exclude food and energy; now we exclude the eight or nine most volatile components to give us a better guide as to whether the trend in inflation has changed, as opposed to volatile components of it, to give it more signal and less noise.

That just helps us appreciate whether the trend is still on track. It gives us a little more insight into whether we're being deluded by a major move in just one or two items. It's as simple as that.

But we do pay attention. Our target is about the whole thing.

The Chair: Okay. I appreciate that.

I will go now to Monsieur Caron, s'il vous plaît.

[*Translation*]

Mr. Guy Caron: Thank you very much, Mr. Chair.

Governor, your predecessor is clearly still very active at the Bank of England, but also as the head of the Financial Stability Board.

There is a lot of talk about our attempts to get out of the crisis we find ourselves in at the moment—a number of countries are in an even worse situation than we are—but we must also not forget the reasons that got us into that situation. The Financial Stability Board is supposed to come to grips with those issues. With Mr. Carney, things were clear because he was the governor of the Bank of Canada. But he is out of the country now.

I would like to know your vision of the role you want to play. What role do you want the Bank of Canada to play within the Financial Stability Board in order to deal with the systemic causes of the crisis that we are trying to get out of?

Mr. Stephen S. Poloz: Thank you for the question.

As I mentioned earlier, the Bank of Canada is a team player. Other team members are the Department of Finance, the Office of the Superintendent of Financial Institutions and the Canada Deposit Insurance Corporation. As part of that team, the Bank of Canada has two roles to play.

First, we have to make sure that the macroeconomic environment is as stable as possible. Specifically, that means that prices are stable.

Second, we must become a kind of advisor, and we must conduct basic, long-term research in order to provide useful material for our discussions. The research has to be very serious.

Our role is to make sure that discussions are based on the best information. That is actually the role that Canada has been playing internationally. We did the same thing with our experience in Canada. Our system was, in a sense, clearly superior to, more robust than, other systems.

Our research indeed helped to make sure that the discussions were based on the best information. That is why Canada's contribution was greater than our size would indicate. The fact that Mr. Carney was appointed to head that organization shows that.

I hope I have answered your question.

● (1025)

Mr. Guy Caron: You have answered it in part.

We are actually talking about the impact of the financial crisis on the banking system. I believe that everyone recognizes that Canada's banking system was more solidly based than a lot of others, and for a number of reasons. But Canada's financial system was affected by things whose dangers were unknown. Things like asset-backed commercial paper and subprimes, for example. Those things came into play and triggered the crisis.

So there is an issue in terms of complex financial tools, which is what the Financial Stability Board is looking into. It wants to see if the system actually is out of control because the tools are so complicated. In that sense, what course will the Bank of Canada set in the Financial Stability Board?

Then, if you have any time left, what advice could you offer, to the Minister of Finance, for example, so that he could play a proactive role in terms of the causes of the crisis?

The Chair: Mr. Poloz, you have a minute left.

Mr. Stephen S. Poloz: The crisis certainly affected our banking system profoundly. The system is quite complex and it is actually getting more complex by the day.

We need a collaborative system where the rules are almost voluntary, given that everyone wants the system to be more robust. That is everyone's goal, including the banks. So we need more extensive discussions of a collaborative nature between the banks and the people here in Ottawa. The Bank of Canada has a contribution to make and has to be part of those discussions. Specifically, it can make a significant contribution in research.

The Chair: Thank you, Mr. Poloz.

[*English*]

In the final round, Ms. McLeod, please, with your questions.

Mrs. Cathy McLeod: Thank you.

Again, I'm really pleased that we've covered a lot of different subjects.

We touched briefly on household debt and how much of a concern that was. I also notice that TransUnion's market trends looked at the latest results and that there was a pretty large reduction, so it's certainly heading in the right direction.

Also of interest to me personally was my meeting this week with the Financial Consumer Agency of Canada, which has actually done some micro-level analysis in the riding that I represent, in terms of a much higher use of lines of credit versus other areas. They were saying that the debt was looking very different and that was very much a regional issue at times.

Could you talk a little bit more of the trend and perhaps on that regional sort of analysis of household debt and its potential impacts?

● (1030)

Mr. Stephen S. Poloz: Yes, thank you.

I should start off by reminding everyone that the world has changed quite a lot in the last 20 or 30 years. Household debt today is probably not easily compared to it 20 years ago simply because the financial system has become so much more flexible—almost self-serve in nature. You have the ability to control your own level of borrowing much more easily than you could in an earlier generation.

That has improved what I call the “efficiency” of the financial system. It means that households may have more debt on their balance sheet, but they may also have more assets, so they've somehow managed that in much the way we think of a firm managing it. So I don't want to distract our conversation from that, but I just want to remind everybody that we shouldn't look at something that's a certain percentage now and a percentage from 20 years ago and say, “Oh, that can't be right”, because we don't have quite that kind of assurance.

The trends that we're observing, though, are very constructive, as you mentioned. Indebtedness has at least stopped rising relative to income, which is the minimum that we would like to see. As I mentioned before, provided that the rest of our story unfolds as I described earlier, what we'll see is a period where consumers strengthen their balance sheets because they won't be leading the economic growth charge.

The adjustments we've made in the insurance space are obviously contributing to that shift in behaviour, and we wanted to make sure that there weren't any speculative elements emerging in the housing sector, in particular.

The analyses that FCAC have done on a micro level sound great. I know those folks and I'd like to see some of that, but I haven't seen it as yet.

Mrs. Cathy McLeod: Yes, it was interesting because housing costs in our community are certainly less than in a community like Vancouver, so you wonder if people just absorb that level of fluidity and if they're not paying as much on housing if they tend to enjoy other opportunities. So I think looking at the micro level is going to be an interesting opportunity, at least for different members of Parliament.

We've talked about the U.S. and Europe and you touched briefly on where they are in terms of their situations and where you see their future, but if you want to expand a little bit on that, please do.

Mr. Stephen S. Poloz: Thank you.

Let me begin with the U.S., which is largely a good-news story. Certainly in the U.S. we saw very rapid efforts to liquefy the financial system, a very fast response by policy-makers, which meant that unlike in other countries, all the damage was done at the beginning and then the healing process began very rapidly.

Of course, we had a tremendous fallout in the U.S. housing sector. That was the biggest element that was hit hard. We're seeing very positive signs that it is going back to a more normal course. This is very important to Canada since we export materials that often go into that equation.

Importantly, the U.S. economy, fundamentally, is stronger than it appears as a headline, because we have a significant fiscal adjustment layered on top. The part of the U.S. economy that we export to is more the private part than the government part. That's one of the reasons why EDC's export forecast for the U.S. is stronger than you might have guessed, given how much growth we expect to see in the U.S.

In Europe there is a different story, obviously. It remains in a very difficult situation. We have there, if you like, institutional gaps that have made it difficult for them to do the same things that the rest of us tend to take for granted in policy action.

I would say that those institutional gaps persist, but I am encouraged that though they persist in practice, the intellectual leap has been made. The bridges have been built. People understand what is needed. So I have to believe that being constructive about what's going on in Europe is the right thing. We think it will gradually improve, but it will be a very prolonged story.

● (1035)

The Chair: Thank you.

Thank you, Ms. McLeod.

Governor, on behalf of all the committee members, I want to thank you so much for being with us here today and for your dialogue with us

As we did with Governor Carney, we would like to host you twice a year, once in the spring and once in the fall. We certainly look forward to continuing the dialogue with you at the committee. We appreciate your time here.

Colleagues, I will suspend for one minute and then we have some brief committee business to do.

Thank you.

[*Proceedings continue in camera*]