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**EVIDENCE**

## Wednesday, April 12, 2017

## Chair

**The Honourable Wayne Easter**

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● (1625)

[*English*]

**The Chair (Hon. Wayne Easter (Malpeque, Lib.)):** I'll call the meeting to order. Pursuant to Standing Order 108(2), we are studying the report of the Bank of Canada on monetary policy and welcome before the committee today Stephen Poloz, governor of the Bank of Canada, and Carolyn Wilkins, senior deputy governor.

Governor, the floor is yours and then we'll go to questions. Welcome.

**Mr. Stephen S. Poloz (Governor, Bank of Canada):** Thank you, Chair, and good afternoon to you and to the committee members.

Senior Deputy Governor Wilkins and I are delighted to be before you today to discuss the bank's Monetary Policy Report, which we published just this morning.

Taking a look back to the last time we were here, which was in October, at that time I spoke about the factors that were causing us to downgrade our outlook for the Canadian economy. Some six months later, I'm very pleased to say that I can discuss the factors that have led us to upgrade our forecast for the Canadian economy.

For some time, we've been talking about how the oil price shock that began in 2014 set in motion a complex series of adjustments throughout the economy, including a significant restructuring of the oil and gas sector. What we're seeing now is that energy-related activity has stopped declining and is transitioning to a new level commensurate with the current level of oil prices.

Now, because that large negative force is now essentially passed, it's no longer masking the sources of strength that have been at work for some time, particularly the growth in output and employment that is being driven by the service sector.

The expansion over the past six months has exceeded our earlier forecast, and we have revised up our outlook for average annual growth for this year, 2017, to a bit over 2.5%. That's half a percentage point greater than we were projecting in the January Monetary Policy Report. We project growth of just under 2% in 2018 and 2019.

A crucial question for the bank now is whether the stronger economic data we've been seeing recently are signalling increasing momentum. Some of the strength is coming from factors that are unlikely to continue at the same pace. For example, the very strong growth in consumption in the first quarter was supported by a temporary boost from the Canada child benefit.

Housing activity has also been stronger than expected. While we've incorporated some of this strength in a higher profile for residential investment throughout our projection, we're still anticipating a slowing over that projection horizon. The current pace of activity in the greater Toronto area and parts of the Golden Horseshoe region is unlikely to be sustainable, given fundamentals. House price growth in the GTA has accelerated sharply in recent months, suggesting to us that speculative forces are at work.

In terms of the labour market, recent data have been more mixed. Job growth has certainly been firm, but both wages and unit labour costs have grown very slowly. The data suggest that material slack remains in the Canadian labour market, in contrast to the U.S. labour market, which is close to full employment.

At the same time, Canadian exports and business spending are still weaker than you would expect to see at this stage of the business cycle. Companies are telling us that while they plan to raise spending, the planned increases are modest or tied to maintenance rather than expansion. In short, the economy is not yet firing on all cylinders. In addition, Canadian companies are dealing with heightened levels of uncertainty related to U.S. tax and trade policies.

We still do not know what tax changes are coming, or when, and the range of potential trade measures under discussion is even wider now than it was in January. This list includes, first, a border adjustment tax; second, increased tariffs aimed at specific industries or countries; third, non-tariff barriers; and fourth, even broader multilateral measures.

[*Translation*]

We do not know which of these measures will be enacted; their timing is uncertain and each would affect the global and Canadian economies through a different, complex set of channels. With all this uncertainty, we cannot reliably model the impact of changes to US trade policy. Instead, we have built in an extra degree of caution in our forecast for exports and investment relative to our January projection.

Total inflation has been close to 2% and is expected to dip to about 1.7% in the middle of the year before returning to near its target. However, our core inflation measures are all in the lower half of the target band and have been trending downwards.

● (1630)

This supports the view that the economy continues to have significant excess capacity. Our current base-case forecast calls for the Canadian economy to absorb its excess capacity sometime in the first half of 2018, which is a bit sooner than we projected two months ago.

[*English*]

We are certainly happy to see the recent strength in the economic data, and we want to see more of it to be confident that growth is on a solid footing. We judge that the economy still has material room to grow, and we remain mindful that significant uncertainty continues to weigh on the outlook. Given all of this, we judge that the current stance of monetary policy is still appropriate, and we maintain the target for the overnight rate at 0.5%.

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

**The Chair:** Thank you very much, Governor.

We will turn to questions, with five-minute rounds to try to give everybody a chance to get theirs in.

Ms. O'Connell.

**Ms. Jennifer O'Connell (Pickering—Uxbridge, Lib.):** Thank you, Mr. Chair.

Thank you both for being here today.

I want to start by asking a question on a statement of yours that was quoted in the media at the latter end of last year with regard to your thinking that one of the most dangerous risks to the economy was high household indebtedness. We just completed a study on housing looking at high household indebtedness.

If you believe that the recent federal measures will deal with that or if you have any overall thoughts, I wonder if you could elaborate, including if you've seen any trends, or if the policy has been working from the time you made those comments, which I believe was last December.

**Mr. Stephen S. Poloz:** Of course.

That occasion in December was when we published our financial system review, which is a biannual exercise. The next one is in June. It's absolutely true that a major risk that we face is that indebtedness in households is at the highest level ever and is continuing to move higher. This is closely associated with imbalances in the housing market, because indebtedness is incurred primarily to buy houses. We are confident that the moves made by the federal government, in about the same time frame, are having the desired effect. That means that people are qualifying for mortgages at a higher interest rate now, and therefore have more of a cushion in their financing plan, should there be either an interruption of employment or a rise in interest rates. There is more resilience in the system, and a growing amount as each new bit of debt is subject to those higher criteria. That's the primary change that's been made.

From the Bank of Canada's standpoint, our primary mission being inflation targeting, that implies bringing the economy back to full capacity. That causes more jobs and income growth, which improves the denominator of the ratio of debt to income and makes the whole situation less risky.

**Ms. Jennifer O'Connell:** Thank you.

In recent days questions have been raised in the media around rising interest rates and how much U.S. monetary policy will have an impact on us here in Canada. We have seen interest rates increase in the U.S. Again, I understand the speculation, but how much of U.S. monetary policy affects us here in those respects, especially in terms of interest rates? That's what the average Canadian is going to be worried about, given this high indebtedness.

**Ms. Carolyn Wilkins (Senior Deputy Governor, Bank of Canada):** Certainly what people observe, and they've been observing for a very long time, is that the interest rates in Canada are highly correlated with interest rates in the U.S., especially the longer term those interest rates are, for example, the five-year rate, on which a lot of mortgage rates are based. As the Federal Reserve starts to tighten interest rates, we're going to quite naturally import some of that rise. In fact, we have seen that. It's not a large amount, but over the last six months it's been noted.

Whether or not that's translated into mortgage rates is a question for the financial institutions that set them. They've taken a little out of their margins rather than increase rates.

We have an independent monetary policy, and we set our interest rates commensurate with what we think we need to have to achieve our inflation target. If we're at a different point in the cycle, which we are right now, our interest rate paths are going to be different. We do take that into account when we do our projections. Where the curve says the interest rates are and where we think U.S. growth is, is what we feed into our forecast.

● (1635)

**Ms. Jennifer O'Connell:** My quick question would then be this. You stated that we independent policies from the U.S., and I get that, but should Canada make maximum employment an explicit goal of the Bank of Canada, as the U.S. has done, or does that also fall into a question of our not being at the same point in the cycle?

**Mr. Stephen S. Poloz:** In fact, we see no inconsistency in this. For us, with the inflation target being our goal, we need to achieve a position whereby we've achieved a 2% inflation that is sustainably at 2%. Being sustainably at 2% would mean that there is no excess demand or excess supply in the economy pulling it down or pushing it up, so there is in effect a coincidence: that we would also be at maximum employment at that same time.

For us, then, the two are not distinguishable, but I think that having purely an inflation target improves the clarity of the decision-making we have, because of course in the background the economy is working through its adjustment processes. It's very difficult to have two targets with really only one instrument doing that.

**Ms. Jennifer O'Connell:** Thank you very much.

**The Chair:** Thank you all.

We'll turn to Mr. Deltell.

The floor is yours.

**Mr. Gérard Deltell (Louis-Saint-Laurent, CPC):** Thank you, Mr. Chair and colleagues.

[*Translation*]

Mr. Poloz, Ms. Wilkins, welcome to your House of Commons.

First of all, I would like a little clarification. At the outset, you mentioned the price of oil, which has clearly been major concern in the last four years in Alberta, especially if we consider the terrifying effects we have seen.

You say that we are transitioning to a new price that is commensurate with the current price of oil. In your opinion, does that mean that, in the next year, the price of oil will be stable? Or are you forecasting an increase? If so, what do you see as the target price for a barrel of oil?

**Mr. Stephen S. Poloz:** For us at the Bank of Canada, forecasting the price of oil is a challenge. As a result, we base our forecasts on a stable price. Then we analyze the other risks.

For the moment, I would say that there is a short-term upside risk because we are going through a period of very low investment in the sector. Sooner or later, demand will exceed supply.

In addition, technological changes alter the supply curve in a very unpredictable way. So I do not really know what the future holds. I am pleased to see the industry becoming more stable, and assuming stability.

**Mr. Gérard Deltell:** Thank you very much.

You mentioned a possible rise in the price of oil. We can understand that this is something that our Alberta companies, and all Canadian companies depending on oil, are hoping and waiting for.

Before I go any further, Mr. Poloz, let me thank you and congratulate you for the quality of your French. We appreciate it greatly.

In terms of interest rates, people are always a little nervous when they are in debt and when deficits are being run. I will not make a political speech such as we have become used to for a year and a half, but, in your opinion, should the interest rate remain stable? Do you foresee any fluctuations in the coming year?

● (1640)

**Mr. Stephen S. Poloz:** I am not going to forecast interest rates. As we said earlier today, we are essentially in a neutral situation in terms of interest rates. The forecasts we made this morning are based on an inflation rate of 2% in this period and on an output gap that will be closed in the first half of next year. Those data tell us that the interest rate today is appropriate. We will have to monitor all the data all the time in order to get a sense of the situation next year.

**Mr. Gérard Deltell:** Okay.

You say that the economy is not yet firing on all cylinders and that there is uncertainty about the United States. The American president has talked about tweaks in trade relations between Canada and the United States. Tweaks for the Americans means a major impact on Canada, as former Prime Minister Brian Mulroney so rightly said two weeks ago at the meeting he attended in Ottawa with some federal ministers.

In your opinion, which sectors of the Canadian economy are most at risk if those tweaks have a major impact on Canada? What impact could that have on the economy as a whole?

**Ms. Carolyn Wilkins:** When we did our analysis, we saw a number of possible scenarios. As a result, it is difficult at the moment to provide a precise answer to your question.

In our report on monetary policy, we tried to identify the channels of change that could affect the Canadian economy. If there were tariffs, for example, the impact would certainly be felt more on the industries directly involved. If a tariff affected some industries specifically, it would have a different effect across the country. Actually, that is what we can see at the moment in forestry.

There are also other channels of change, like the oil price shock, which has implications on broader sectors. For example, workers may have to move in order to find jobs in other provinces or other sectors. There are also capital investments in other industries. Changes like that will require an adjustment that could take time and, basically, result in productivity rates that are lower than they are at the moment. This is because of the global value chains that have been built during all these years of globalization. Those chains are effective, but if they start to become unravelled, we will once more have production chains that are less productive.

That is why we are saying that, if it happened, the effects would be very negative, but at the moment, it is not possible to say specifically whether it will happen.

[*English*]

**The Chair:** Thank you very much.

Mr. Dusseault, go ahead.

[*Translation*]

**Mr. Pierre-Luc Dusseault (Sherbrooke, NDP):** Thank you, Mr. Chair.

Thank you both for being here today.

First, I am going to ask a question that perhaps you were not expecting today.

Some time ago, a number of observers and even economists said that the mandate of the Bank of Canada changed in 1974 and, since that time, it can no longer lend money to the Government of Canada. I would like to give you the opportunity to reply to the questions that have been raised many times in public debate, as to why the Bank of Canada no longer lends money to the Government of Canada. Perhaps that would enlighten all those who have written about the subject.

● (1645)

**Ms. Carolyn Wilkins:** There is a difference between what we have the legal right to do and what we prefer to do in practice.

A central bank sets itself apart by virtue of its independence, its well-established target and its requirement to be accountable as a result. The monetary policy framework that we have chosen targets the rate of inflation. That is an understanding that the Bank of Canada has renewed with governments over the last 25 years, and we have just done so once more. That is the best way for the bank to promote a macroeconomic environment that favours investment and a stable economy for households and businesses. If we added direct money loans to the government to that mix, we would change the objectives and the mandate of the central bank. That could result in less clarity about our inflation rates and would, at the end of the day, be detrimental to our financial stability.

**Mr. Pierre-Luc Dusseault:** Thank you for that answer.

In your presentation, you said that wages and unit labour costs have grown only slowly.

Do you think that wages are likely to improve in the coming years?

Could you tell us why wages have stagnated in recent years and whether the situation is likely to improve?

**Mr. Stephen S. Poloz:** There are two factors. First, we went through a period of slow growth, starting in 2008. In that period, there was quite a wide output gap, particularly in the labour market. That is what explains the long period of stagnation.

As well, the price of oil fell. That is the second factor. Just when the economy was growing strongly, we received that second shock, which required a major adjustment to the economy. That is a long process. Specifically, it represents an annual loss of income of $60 billion for the country. An impact like that does not just affect the people in the sectors that are directly involved. It affects almost the entire economy.

For those two reasons, there were downward pressures on the inflation rate and also on wages. We are expecting that the output gap will close again in the first half of next year and that wages will eventually see a little more growth. That is a sign of progress. At the moment, it is clear that growth has not really taken hold. It's a little uneven. The foundation is not solid. According to our forecasts, however, it will become stronger and more stable.

**Mr. Pierre-Luc Dusseault:** If I have any time left…

[*English*]

**The Chair:** We may get back to you again, Pierre.

Mr. Sorbara.

**Mr. Francesco Sorbara (Vaughan—Woodbridge, Lib.):** Thank you, Mr. Chair.

Welcome, Governor and Senior Deputy Governor. It's always a pleasure.

Reading through the Monetary Policy Report this afternoon, I note two great things. One, obviously, is the stronger than expected growth, as you revised up this year's growth. The other is the output gap closing earlier than expected—although from reading it, I understand there is going to be some remeasurement or re-examination of how we look at and measure output gaps.

One thing I wanted to talk about quickly is exports and business investment, the two points of contribution to GDP that haven't recovered as strongly as we would have expected from an economic crisis or in a cycle. Could you give us some more detail on what the bank looks at in those two areas of contribution to the economy?

● (1650)

**Mr. Stephen S. Poloz:** These things pretty well go together. At the root of this is that during the strong dollar period, followed by the global financial crisis and the global recession, we lost some 8,000 to 10,000 exporting companies that went out of business.

When the conditions for recovery were in place, with the U.S. economy getting stronger and the Canadian dollar easing back, that combination would normally have produced a much stronger export recovery. In fact, what happened was that many of those companies were no longer there, so they didn't respond to that stimulus in the way our models would have predicted.

We have been busy during this period, remodelling the sector at a more micro level. There is plenty in there to encourage us. There are sectors that are emergent and are growing faster, so that's a good thing, and there are others, of course, that are not.

Together with that is the investment side. What we were expecting was that exports would grow to a point where companies were fully using their resources and then would expand through new investment. That natural sequence has not really gotten under way, for the reasons I've just said.

If I may say so, one last thing is the cloud of uncertainty coming from south of the border, which is causing companies to hold back on those investments.

**Mr. Francesco Sorbara:** Of course.

Just changing tangents to the regional housing market, and I say "regional" for a purpose, the GTA in my understanding is probably growing at a 4% to 5% clip a year. You commented recently about some of the fundamentals supporting the housing market, but with the caveat that you see levels of speculation.

Many of us hear from our constituents all the time about the affordability or unaffordability, but mostly the unaffordability, of housing in the GTA. You've also commented, Governor, and please correct me if I'm wrong, about some supply issues.

If we were going to rank the reasons for the rate of price increases we're seeing, what would your comment be on those? Can you add some colour there, please?

**Mr. Stephen S. Poloz:** If we begin at the most basic, a price change is always a question of demand or supply, or both. Demand, as you say, has been growing in the GTA, but the economy has been growing at 4% to 5%. It's being fuelled by immigration and job creation. That creates a very basic demand for more housing. Supply has been growing but has not kept up with that demand, and so there's a natural tendency for prices to rise. Those are fundamentals.

However, there's no fundamental story that I could tell that could justify price rises of 20% or 30%, so without being specific about just how much of it is due to speculation, it's obvious to me that a growing amount is due to speculative behaviour, which means people buying housing not to live in but to flip, etc., for investment purposes.

That of course is a more risky phase of any cycle. It means that it's time to remind people that house prices can go down as well as up and that they should be doing their own risk assessments, fundamentally asking, for example, “Why am I buying this house”, and “Could I withstand a 10% correction in prices?” Many ordinary people could; they would just continue to pay their mortgage and live there. The speculators, however, would not be able to do that, and so it's financially risky.

**Mr. Francesco Sorbara:** Mr. Chair, do I have time for one more?

**The Chair:** No. We might get back to you later.

**Mr. Francesco Sorbara:** Okay. Thank you.

**The Chair:** Mr. Albas.

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

Thank you to our guests for being here, and for the work you do for Canadians every day.

We're obviously in a period of divergent policy, in which the U. S.... I take the point of the senior deputy governor that while the Bank of Canada is an independent institution, many people would cite the equally true fact that we're in an interdependent and integrated economy with the Americans. We're holding steady, with interests rates at least. I'm not going to ask you to comment on where they might go, but what does it mean in practical terms for our dollar, etc., if the American rates are going up? What has your modelling shown?

● (1655)

**Mr. Stephen S. Poloz:** It's true that the Canadian-U.S. economies are highly integrated, and we're to a lesser degree integrated with lots of economies, but the one kind of disturbance that breaks that integration is the one we came through, which is the oil price shock. The decline in oil prices is fundamentally good for the U.S. economy, because it's a net importer of oil, and fundamentally negative for the Canadian economy, because we're a major net oil exporter.

That difference caused a divergence between the two economies, and it's the reason that our progress in reducing our unemployment rate stopped at the time of the oil price shock. In the U.S., progress in reducing theirs actually picked up speed, and so their economy has reached full employment far before we have. This is a divergence in levels or of point in the cycle, and not necessarily of growth rates.

In that context, it's very important that we be clear that we are conducting independent monetary policy. We can't just follow the U. S., because if we did, we would for sure undershoot our inflation target, because we would have excess capacity. That is one of the reasons we have a flexible exchange rate: to give us that policy independence. If we had a fixed exchange rate, we wouldn't have any.

**Mr. Dan Albas:** On the point that we have a floating currency— and of course, you've said that your earlier models may not have told the complete story—with a lower dollar you would think there would be higher exports, and they have not happened. I think that's partly due to the permanent loss of production capacity.

With respect to that—for example, in agri-growth, the chair talks about agrifood as being a leading process—a farmer can choose to plant another acre or not; very firm decisions can happen. For someone to expand or build a new plant, there are many more processes that go into it.

Does the Bank of Canada expect that Canadian exporters will reinvest in production capacity as a result of the low Canadian-U.S. exchange rate, and what other federal measures could help them to increase their production capacity?

**Mr. Stephen S. Poloz:** There are many sectors that are responding, as the textbook would suggest, to the lower dollar. It was primarily in the manufacturing sector where we lost those 8,000 to 10,000 firms, and so we are getting classic responses across the economy. An example is the food business, which is very strong. Another one is IT services, which is a very big, growing business, or tourism, and furniture. There are classic examples.

We're confident that process is working as it normally does. It's just proving to be slower than in the past, and it will rely on the creation of new businesses as we go through time to fill in the room that's been left behind by a smaller energy sector.

**Mr. Dan Albas:** Thank you.

We were talking about household indebtedness. Often people associate mortgage debt with household debt. Household debt is obviously a more expansive term that could include mortgage debt. Is there risk in the non-mortgage sector? The government has already taken very draconian efforts in that respect. Do you see that there are other actions that are necessary or would be helpful to limit risk when we're talking about overall household indebtedness?

**Mr. Stephen S. Poloz:** I'm afraid I don't have the statistics in front of me, but the vast majority of household indebtedness is because of mortgages, not consumer debt. There is, of course, automobile debt and other debt. So that exists. I don't want to dismiss it. In some respect, there are some warning signs, such as lengthening terms on car loans, for example, and people going into negative equity on their car loans, and that sort of thing. There are some issues there that are symptomatic of risk, but the lion's share of our concern is related to the housing market. Either way, we generally think of household debt as one thing because it is actually quite commingled, and it is high.

I want to make one last comment before the chair stops me, which is that, as the stock of debt as a share of our economy rises, it's usually not because of individuals becoming more indebted. It is usually because of individuals with no debt becoming indebted for the first time, in buying their first home in particular. Given the new requirements that have been put in place, we know the stock of debt is becoming more sustainable as time goes on because of those new rules.

● (1700)

**The Chair:** Thank you both.

Mr. Fergus.

[*Translation*]

**Mr. Greg Fergus (Hull—Aylmer, Lib.):** Thank you.

Governor Poloz, Senior Deputy Governor Wilkins, thank you for joining us. The quality of your French is extraordinary. I would also like to recognize the collective work you have done to make sure that the Canadian economy is functioning well.

I feel that all my colleagues around the table will agree that, when the economy is going well, it has very positive effects on our immediate political situation. Of course, that is not a concern for you.

In the “Monetary Policy Report—April 2017”, published today, you say that the economy performed better at the end of 2016 and the beginning of 2017 which could partially be attributed to the Canada Child Benefit.

In whichever language you choose, can you give us a brief overview of the effect the program has had on the Canadian economy and tell us why you forecast that the effect will not continue through the coming months?

[*English*]

**Ms. Carolyn Wilkins:** Sure.

[*Translation*]

The real effect of the program was to increase parents' disposable income. That means that parents must then decide whether they want to spend the money, save it, or use it to pay down their debts. We projected that parents would choose to spend a little and save a little, and that is exactly what we observed.

However, we were surprised to see the effect was much more concentrated in time than we would have thought. This kind of change increases income levels once, but it continues to another level. The effect on the level of consumption is permanent, but, unless the amount continues to increase, the effect on growth disappears. That is the basic arithmetic of growth.

In a nutshell, a one-time increase in income level is very positive, but it cannot continue if the amount of the increase remains the same.

[*English*]

**Mr. Greg Fergus:** Can we measure how much of an effect the Canada child benefit has in that one time? It just puts us—

[*Translation*]

**Ms. Carolyn Wilkins:** An estimate was made, but I must confess that I don't have the figure at hand. Mr. Poloz, do you recall the figure?

**Mr. Stephen S. Poloz:** They spent about 50%.

**Ms. Carolyn Wilkins:** They spent about 50%.

**Mr. Stephen S. Poloz:** On average.

**Mr. Greg Fergus:** That comes back to the question you asked about the level of Canadian household debt, which is quite a serious problem. It's good that you are trying to find the right balance and to keep a key interest rate that encourages economic growth within a certain range. Since that was established in the the 1990s, you have been doing a good job and are continuing along the same lines.

The key interest rate is at a historic low. How can we adjust that key rate to ensure that Canadian households do not incur more debt? At the same time, we do not want to put the brakes on economic growth. We know very well that the indebtedness is because people are spending, which in turn stimulates economic activity.

● (1705)

**Mr. Stephen S. Poloz:** That is a very complex question.

Frankly, the key interest rate is only one instrument. Your question involves a number of objectives.

Our first objective is to maintain a stable inflation rate. If the inflation rate remains at 2%, the rest of the economy is in balance. We have achieved the best of everything while keeping the inflation rate stable. The inflation rate influences everything else.

Indebtedness is something else. The indebtedness has accumulated over a long period of time. Our way of resolving it is to keep the economy in balance. It will then take time for everything else to adjust.

[*English*]

**The Chair:** Mr. Liepert.

**Mr. Ron Liepert (Calgary Signal Hill, CPC):** Thank you, Governor.

I want to follow up a little bit on my colleague's questions about the dollar.

I recognize that there are many things you put into the hopper, and they stir around and come out the other end, but for the economy to continue to grow, what in your view is an appropriate level for the dollar? Is it 75¢, as it is today, and as it seems to have hung around for the last couple of years?

**Mr. Stephen S. Poloz:** We don't form a view in the way you describe. In fact, the Canadian dollar is most correlated with the price of oil because of the importance of oil in the economy. When the price of oil was around $100, the Canadian dollar was in the nineties—actually around a hundred cents.

We have models that try to capture the historical relationship between oil and the dollar. The dollar does have some other things to it. Not just oil, but other commodities matter, and the interest rate differential between Canada and the U.S. matters. But that's about it. It's a pretty simple model of how the exchange rate is determined.

In real life, everything that moves affects the market's estimate of what interest rates will be some day, because it interacts with what inflation will be. That means that anything that moves can affect the dollar, because it changes that expectation.

In economists' models, really, anything that moves in the model, the exchange rate reacts to. It makes it very hard to ever form a view of what the appropriate level is. It all depends on the forces acting on the economy at the time.

There simply is no hard and fast rule. As I said earlier, that's exactly why we have and why we need a flexible exchange rate. We can't be forcing it to be somewhere or expecting it to be somewhere. So many other forces can act on it. We need to focus on something that is of general use, and that is the inflation rate, which thereby clarifies decision-making both for businesses and for households. That's something they can count on, that we're going to keep inflation close to target.

**Mr. Ron Liepert:** I don't disagree with anything you've said. I just think that if we took some of your modelling that you talked about today, which, again, I don't disagree with—the 50-buck oil or whatever the modelling was based on—we can see that we have a number of warning signs from the U.S. on everything from increased interest rates.... I don't even think that's a warning sign. I think that's a given. We've pretty much indicated that we're not going to go there, whether it's a border tax or whatever it is. All of these things that are likely coming at us are going to continue to put pressure on the Canadian dollar. At least, that's the common belief.

For starters, would you agree with that? Then, if that is the case—and I recognize that I've started my question with "if"—where do we get to on the point of the dollar if the dollar happens to get.... Is a 65-cent dollar good for the country or not good for the country? It's always been the belief that a low dollar drives manufacturing exports. As we've discussed, it has to a degree, but not to the degree that could offset the impact of oil prices. I'd just like to get a sense from you on that, but primarily the external factors from the U.S.

● (1710)

**Mr. Stephen S. Poloz:** In the U.S. case, everybody in the marketplace knows that the U.S. economy is at full employment and that they have begun to normalize interest rates. Everybody also knows that the Canadian economy is in a different spot and that we're likely to strike an independent course. Those two understandings are built into the marketplace and are in the prices that we see today.

Assuming that those two things unfold as people expect, I would not expect large movements in the Canadian dollar, but if something else changes, such as the price of oil, for example, then it would.... It's why we can't make some sort of firm prediction. It's really the market that drives it, and we appreciate that, because the market sees everything, and all those transactions, billions of transactions, are driving the dollar around. It would be wrong for us to try to offset those things.

Finally, is a low dollar always a good thing? Well, it is selectively good. It is good for a company that has mostly Canadian content in their business. That would be, say, in agriculture, but not necessarily, because equipment may be imported.

**Mr. Ron Liepert:** Yes.

**Mr. Stephen S. Poloz:** We're always hearing from companies that it's a two-edged sword, isn't it? There is no simple case for a low or a high dollar. It's driven around by these forces.

**Mr. Ron Liepert:** Very briefly, Mr. Chairman, we've recently had a number of foreign companies in the oil sands sell-off, indicating that they're not going to continue operating in the oil sands. Does that pullback of investment give you any concern?

**Mr. Stephen S. Poloz:** No, it doesn't give me any concern. In fact, I see strong international interest in Canada as an investment destination. It's been enhanced, actually, in recent months, I would say. I think that is purely a sectoral decision by a global company that has multiple opportunities to deploy capital and has reassessed its situation. I don't think of it as a nationality thing in any way.

**Mr. Ron Liepert:** Thank you.

**The Chair:** Thanks to both of you.

Mr. Grewal.

**Mr. Raj Grewal (Brampton East, Lib.):** Thank you, Mr. Chair,

Thank you, Governor and Deputy Governor, for being here. I really appreciate it.

There was an article in *The Globe and Mail*, just before you sat down, that said you were commenting on speculative risk in the Toronto housing market. This committee studied housing and is about to present a report to Parliament. The housing question is obviously a regional problem. There are different issues in different parts of the country.

In my neck of the woods in Brampton, it's just gotten out of hand. In Brampton East, the month-over-month price increases are $30,000. It's very much speculative in nature, with people owning four or five homes.

What type of risk does this present for the Canadian economy? In your opinion, would an interest rate hike help slow down the speculative nature of the housing market?

**Ms. Carolyn Wilkins:** We've discussed this at length in the financial system review. What we see is a combination of very elevated prices that may not make much sense if you look at the fundamentals combined with a large amount of debt. And it's not just aggregate debt. If you look at the different neighbourhoods where prices are high, you see that the people living there and have the mortgages are also the most indebted. They may have debt-to-income ratios over 450%.

That combination creates a vulnerability. We call it a vulnerability because what it needs is a trigger to make that vulnerability turn into a risk that materializes. Of course, this would be a big drag on the macro- economy, depending on how big and widespread the event was. In the worst case, it would be an issue for financial stability. If you read our FSR, however, you know that that would take a really big event for it to get to that point.

Yes, we think about it, but the factors that might lead to these big price increases often are not treated as well as they could be by an increase in the interest rate. An increase in the interest rate would affect the whole country, including whole provinces where this isn't an issue at all. It's quite a widely spread instrument when we use it, and it's very effective. At the same time, you could look to other policies that are actually much more effective and more targeted. We saw some of them in action last year in Vancouver.

Another point we've made is that if you think you're investing and you're going to get a 20% or 30% return, it's not clear to us that raising the interest rate—a difference in an interest rate of 50 basis points or 200 basis points—is really going to change your mind on a rate of return that's really that lucrative. You combine this with the fact that, if you look at our credit numbers, it's actually not a credit-driven price cycle at this point.

I would say that the monetary policy tool would be the wrong one at this point.

● (1715)

**Mr. Raj Grewal:** Thank you very much for your comments on that.

You mentioned the debt-to-income ratios of Canadians. There is obviously a lot of concern when Canadians are stretching themselves a bit too thin. It's happening a lot in our neck of the woods. If a middle-income family has a home in Brampton East that they probably bought for $550,000 to $600,000, that home might be worth a million dollars, and that's only in the last four or five years. Now they've taken out the equity and put down a deposit on two or three homes. At the same time, they have two SUVs they have financed, and they might have a kid they're paying tuition for in college or university.

To me this is the biggest risk to the housing market, because people are then going into the secondary market to close on these deposits they've made on homes that haven't been built yet in order to close on the mortgages, and they're paying 12%, 13%. We don't have the data, and this never shows up in your debt-to-income ratio.

In your report you mentioned that it would be catastrophic to get to that point, as though we're now far from a housing crash. In certain regions, however, if that were the scenario, would it not present legitimate risks for the Canadian housing market? If something happened in Brampton or Toronto, wouldn't there be ripple effects all across the country?

**Ms. Carolyn Wilkins:** It's difficult to speculate. “If something happened“ is very general terminology. As to how much it would ripple across, it would be very unfortunate for the people in that area, and I don't want to minimize that at all.

What we've seen when you look at past housing price cycles is the amount of contagion depends on a couple of factors. One of them is just how big the price adjustment is in that particular area and how important that area is to the rest of the economy. If it's relatively small, then contagion is probably a low risk. If it's quite large, however, particularly in an area like the GTA and Brampton, I would say that the chances are higher that there would be contagion to other markets, because it would affect price expectations in other markets. It really would just depend.

Whether or not this would lead to a very large macro-economic cycle, a recession, would again depend on what else was going on in the environment. If the economy were still growing and benefiting from growth in the U.S., that would be one case. If, at the same time, there were some negative events from outside that amplified that price adjustment, then it could create some macro-economic problems.

**The Chair:** Thank you both. I'll have to stop it there.

Mr. Dusseault, you are down to three minutes.

[*Translation*]

**Mr. Pierre-Luc Dusseault:** Thank you, Mr. Chair.

[*English*]

**The Chair:** Then we'll go back to you for five minutes.

[*Translation*]

**Mr. Pierre-Luc Dusseault:** I would like to quickly go back to the question of the dollar. In my constituency, Sherbrooke, in the Eastern Townships, we are very close to the American border.

Does your model project that the value of the Canadian dollar against the American dollar will remain stable at more or less at the current value in the coming months and years?

● (1720)

**Mr. Stephen S. Poloz:** No. We do not make forecasts for the Canadian dollar. In the report we published today, we assume that the Canadian dollar will remain stable through the entire forecast period. As I mentioned before, a number of things make it very difficult to do. I must tell you frankly that, if we make a projection, it will influence the market. We prefer the market to behave normally, completely on its own.

**Mr. Pierre-Luc Dusseault:** Thank you for your answer.

My concern is that the population is aging. I do not know if you have any projections or data on the matter.

We hope that most people will have saved for their retirement, but some data show that savings are perhaps not top of mind for a lot of people who are approaching retirement.

Do you have any data on Canadians' savings? Do you have any data on the potential risk to the economy of soon having a large number of new retirees with no savings and no ability to remain fully active consumers in the market?

**Ms. Carolyn Wilkins:** We look at the overall rate of savings in the economy. At the moment, that rate is about 5%. When you look at the savings of older Canadians, there is a whole range of possibilities. Some people are finding themselves in a situation where they need to work a little longer. We have not gone into that matter in depth.

We can say that, in the labour market, we can see that the level of activity for older people has increased. People are working longer than was normal in the past. With the data at our disposal, it is difficult to say whether those people are making that decision because they like to work, because they are in better health and living longer, or because they are in financial need.

[*English*]

**The Chair:** Thank you, Pierre.

Mr. Ouellette, you have five minutes.

[*Translation*]

**Mr. Robert-Falcon Ouellette (Winnipeg Centre, Lib.):** Thank you, Mr. Chair.

My thanks to the witnesses for coming to the committee today. It is kind of you.

The Bank of Canada is responsible for monetary policies, financial systems and financial management.

[*English*]

I was just wondering what tools would be available to the Government of Canada and the Bank of Canada if there were a major disruption in our economy, for instance—not the American economy, but our own economy. If there were large unemployment, what would you be able to do in addition to what you're already doing with a low interest rate, in order to get more people back to work, for instance?

**Mr. Stephen S. Poloz:** The tools of economics have not really changed in all these years. Canada's federal system is in a very strong financial situation, and we would be able to deploy fiscal tools in order to stimulate the economy.

On the monetary side, we're already at a very low interest rate. That would be of some concern, that we would start with a low rate —

**Mr. Robert-Falcon Ouellette:** That would be something that would be excluded, because we're already at a low interest rate.

**Mr. Stephen S. Poloz:** No, I'm just finishing my thought.

**Mr. Robert-Falcon Ouellette:** Okay, sorry.

**Mr. Stephen S. Poloz:** No, I would not exclude it. We have actually studied this carefully. We've been through a phase where many central banks had their interest rates at what we thought was the lowest possible level, but have actually worked with interest rates below zero to good effect. Europe, for example, is turning around nicely now. That is, in part, the product of negative interest rates, whereas there was very little by way of fiscal expansion.

That's to say there is some room to manoeuvre on the monetary side and probably more room to manoeuvre on the fiscal side. Moreover, we're in a state with the economy where fiscal policy has a greater impact because of where interest rates are.

● (1725)

**Mr. Robert-Falcon Ouellette:** What do you mean by the fiscal policy? Can you explain that a little more?

**Mr. Stephen S. Poloz:** What do I mean by fiscal policy?

**Mr. Robert-Falcon Ouellette:** Yes.

**Mr. Stephen S. Poloz:** That would be programs, such as the infrastructure program, spending federal dollars on investments that promote longer term economic growth, as well as creating employment in the short term.

**Mr. Robert-Falcon Ouellette:** What would happen if we're already doing all of that and we had a major disruption in one important sector, which saw a lot more unemployment?

**Mr. Stephen S. Poloz:** You're talking about just one sector?

**Mr. Robert-Falcon Ouellette:** If oil prices were going up, could we increase our infrastructure spending? It's a hypothetical situation —

**Mr. Stephen S. Poloz:** Yes, that's very hypothetical.

**Mr. Robert-Falcon Ouellette:** What would you counsel?

**Mr. Stephen S. Poloz:** The answer would be, especially if the shock is in a particular region or a particular sector, then fiscal policy is much better able to target an area geographically, where more assistance is needed, or to customize the EI program or other things to help a particular sector, whereas monetary policy, as Ms. Wilkins was saying earlier, is generalized across the entire economy.

**Mr. Robert-Falcon Ouellette:** Could EI be an important tool if we extended the EI period for certain sectors that are suffering?

**Mr. Stephen S. Poloz:** We're getting very hypothetical. I'm here to talk about monetary policy.

**Mr. Robert-Falcon Ouellette:** Yes, of course.

**Mr. Stephen S. Poloz:** I'm just saying that fiscal policy would be in the suite of tools that would be more effective given that interest rates are already very low.

**Mr. Robert-Falcon Ouellette:** Okay. What would happen if we brought our interest rate lower and the United States rates climbed higher? What would be the impact on the Canadian dollar?

**Mr. Stephen S. Poloz:** It would depend on what else was going on. As I said before, there are many forces acting at the same time. However, if that were the only thing that changed, most models would predict that the Canadian dollar would depreciate further in the situation you're describing.

**Mr. Robert-Falcon Ouellette:** Do you believe that would help out the manufacturing industry in any substantial way, Ms. Wilkins, as we've seen in the past?

**Mr. Stephen S. Poloz:** As I said before, it may, but it would be sector specific. In many cases, a lower dollar doesn't bring benefits of the sort you have in mind. In other sectors, it does. It would change the distribution of growth through the economy.

**The Chair:** Could we have your last question, please?

**Mr. Robert-Falcon Ouellette:** Has the Bank of Canada been looking at the impacts that automation might have in certain job markets and in the Canadian economy more generally?

**Mr. Stephen S. Poloz:** Not specifically, but perhaps you'd like to say something about it, because you—

**Ms. Carolyn Wilkins:** I've been thinking about it a little bit. I plan to speak on it next week. That's why I smiled.

**Mr. Robert-Falcon Ouellette:** That's wonderful.

[*Translation*]

That works out well.

[*English*]

**Ms. Carolyn Wilkins:** Clearly, we updated our potential output this time. We do it every year. When you do that, you need to take a view on productivity. One of the things you hear a lot about with automation is just how much potential there is to get enhancements in productivity.

Of course, we haven't factored any of that into our shorter term productivity growth, because this is a longer term question. It does raise the issue of what this means for employment and what it means for the distribution of income. I'm going to talk about it a lot more next week, but it's early days for our work on this at the Bank of Canada. Our work is very focused on the issues that are relevant for a central bank, so the transmission of monetary policy is one example of that. It's something that's on our radar, for sure.

**The Chair:** Thank you both. I'll turn to Mr. Albas in a minute. I have a couple of questions and then we'll come back for one more question on the government side.

Just before you start, Dan, I have a couple of questions relating to the discussion with Robert. We did a pre-budget report called, “Creating the Conditions for Economic Growth”. I think it's fair to say that we'll be building on that theme, as we look forward to the pre-budget consultations for next year. Some people have suggested that productivity should be part of that focus, so we'll be interested to see the work that you do on productivity.

You've mentioned that fiscal policy could be part of a suite of policies that might help with economic growth. Do you have any other suggestions for enhancing economic growth? Maybe it's beyond your purview, but productivity is certainly one.

● (1730)

**Mr. Stephen S. Poloz:** Just to be clear, the earlier question posed was that if something bad happened in the Canadian economy, what tools would we use to try to create more employment. The question you're framing, I think, is a little different, so I'll answer it differently.

I think what you want to look for are things that we call the “third leg” of the policy suite, namely, structural policies. These are policies that are, in effect, intended to enhance the ability of the economy to grow, usually by removing impediments to growth rather than somehow trying to boost them.

A good example would be CETA, and another one would be CFTA. These are explicitly designed to remove impediments to business growth and job creation. As is often the case with structural policies, they are literally free money. It's not as if it costs money to do these things. It's changing rules or adapting programs that already exist so they're more effective.

What happens then is, let's say you do something that enhances the labour force participation of women. That increases the labour input for the economy and the potential output of the economy, giving us more room to grow. That would be a structural policy, not fiscal per se, and certainly not monetary policy.

It can work in much the same way as a free trade agreement works to enhance the ability of the economy to grow on its own. There is no end of examples that one could come up with.

**The Chair:** Thank you for that. I think that gives us some food for thought for our fall hearings.

The last question I have, and I think the elephant in the room for our economy, as you mentioned in your submission, is where the United States may go in its trade policies, border adjustment tax, etc.

On a trilateral or global basis, do you have discussions with the U. S. Federal Reserve, and do they talk about how dangerous some of those policies might be to the North American trading relationship and how it might affect all three countries in NAFTA going forward?

I chair the Canada-U.S. committee and that's partly why I ask the question. What happens south of the border, and the great uncertainty that's there now, could really have an impact on our economy and theirs, going forward.

**Mr. Stephen S. Poloz:** The central bankers of the world meet every six or eight weeks at the Bank for International Settlements in Switzerland. Those meetings include Mexico and the United States. We have an almost continuous dialogue about these kinds of issues. In addition, those people meet together with the finance ministers at the G-20 or G-7 meetings a little less regularly.

There's a pretty strong consensus around the things you mention. I argued in a speech a couple weeks ago that much of the world's progress over the last 150 years for Canada, in terms of growth and prosperity, have been in periods that you could characterize as open: open to trade, capital, and immigration. All of the periods in which we were not open were very distressed periods here in Canada. It's an easy correlation to see.

The last time we were closed was just prior to Confederation. Confederation and the free trade agreement implied in it was a response to the closing of international markets—any port in a storm.

In the end, I think there is a strong consensus around these things. I'm hopeful that, as we have dialogue and understanding grows, many of these things that we hold dear are preserved.

● (1735)

**The Chair:** Thank you very much for the openness in that answer.

We'll go to Mr. Albas, then Ms. Taylor.

**Mr. Dan Albas:** Thank you again, Mr. Chair.

I'll pay you a compliment for the new $10 bill and the Konami code. I thought that was quite witty, coming from that generation. I used the code on the chair earlier, but he wouldn't double my time. He says it doesn't work on older systems, unless they're Japanese.

**Mr. Stephen S. Poloz:** Okay.

**Mr. Dan Albas:** Anyway, I just want to ask a few things.

First of all, I'm glad that in your statement here today you addressed the point that American trade protectionism is a worry. I say this because the first half of the report just mentions trade protectionism in itself—although there are pockets of protectionism in some other parts of the world as well. Again, I know it's a difficult discussion, and I'm not really going to go there further because I think we've explored it as far as we can.

I want to talk a little bit about some of the bright spots you've identified, one of them being services. In the report it says that services are showing some potential. Can you give us more of an idea of this? Have there been any particular breakouts or bright spots in the services industry among certain provinces or industries?

**Mr. Stephen S. Poloz:** Indeed. Let met offer a few broad comments, and then I think Ms. Wilkins may have a few details.

In fact, I gave a speech on this at the C.D. Howe Institute back in the fall. There's a whole speech on our website about where the sources of strength are. I'll just mention a couple of the highlights.

The important thing here is that the economy is already transitioning into a much higher percentage of services than goods, and that's primarily because the highest productivity—the new machinery, the new technology—makes the goods sector more efficient. You have supporting businesses being created in the service part of the economy, and they're the ones that are actually very global and, conveniently, have high Canadian content. They benefit the most from a lower Canadian dollar. The situation is very strong in that sector at this time. An example that is really moving hard is IT services. These are very well-paying jobs. Tourism is a big one. Other examples are education services—universities—and health care services.

What have I missed?

**Ms. Carolyn Wilkins:** You have missed motion picture and sound recording.

**Mr. Stephen S. Poloz:** There you go.

**Ms. Carolyn Wilkins:** You get into a lot of industries that, as a share of the total economy, are small, but there are just so many of them. They add up to quite a bit in quite an important way.

**Mr. Dan Albas:** One of the challenges I have as an MP is that when I talk to people about services, they obviously think of the fast food industry. Again, there's nothing wrong with that. However, what we're talking about here, as you said, are usually services that can be exported now. Some of our new free trade agreements include services.

Do you think those are being tracked well enough? Are you getting enough information to track services overall?

**Mr. Stephen S. Poloz:** For the most part, we are.

One of the reasons services are given less of a profile in the media and in general conversation is that we get the trade data each quarter, whereas the monthly report is only about goods. That, I know, is something that StatsCan is working on to improve.

Imagine if the report, every month, included all services. I think we'd all chat about what's going up, what's strong, and so on. When the quarter comes, well, we get the national accounts. Everybody is excited about that, and services take a back seat whereas they actually should be in the front seat.

I'm confident that they're doing everything they can to improve that. For us, it's about those longer trends, anyway. It's not a month-to-month thing that matters.

**Mr. Dan Albas:** Again, when I go to some of these mills, they may be using German or Scandinavian equipment, but it's been reprogrammed by Canadian IT. It actually makes them more efficient —

**Mr. Stephen S. Poloz:** Exactly.

**Mr. Dan Albas:** —and they get better real-time service.

Anyway, there are a couple of other things I will have to talk about, but I think that covers most of it today.

**The Chair:** Thank you very much, Mr. Albas.

Ms. Petitpas Taylor.

**Hon. Ginette Petitpas Taylor (Moncton—Riverview—Dieppe, Lib.):** I have a very quick question.

During the course of the afternoon, you've been asked several questions on the high level of household debt in Canada, and you mentioned that a big part of that is related to mortgages.

At one point you indicated that the stock of debt is more sustainable. Could you elaborate a bit more on that, please?

● (1740)

**Mr. Stephen S. Poloz:** Yes. What I mean by that is that the quality of the outstanding stock of debt is improving through time because of the changes the government has put in place.

If today there is this much debt, the person who goes into the bank tonight and negotiates a mortgage has to qualify at a higher rule level, and so when they get their mortgage, that adds to the stock of debt, but we know that they're more sustainable than someone who qualified for a mortgage, let's say, a year ago or two years ago. That's what I meant. It's a little more resilient because they have to qualify at a higher interest rate. That means that, if interest rates were to go up in the way we described, if U.S. interest rates go up, and five-year mortgage rates drift up, they would already be prepared for it because they've already qualified at that higher rate.

**Hon. Ginette Petitpas Taylor:** Thank you.

**The Chair:** Mr. Sorbara has one question, and that will close our discussion.

Mr. Sorbara.

**Mr. Francesco Sorbara:** Very quickly, I've described the budget that we recently rolled out as focused on skills, training, infrastructure, and innovation. I'd just like to focus on the lifelong learning aspect of skills training. In your opening comments, you talked about wages and unit labour costs being depressed, and there's obviously been an oil price shock, with implications for wages and income levels in Canada. Now looking at how we can get wages rising again through productivity, I think the budget rolls with that. I'm not asking for you to opine on the budget, but I am asking what is the importance of lifelong learning for Canadians in skills training, to make sure our workforce is ready.

**Mr. Stephen S. Poloz:** I would fit this into the segment I talked about with the chair, which is structural policies, which can be very powerful because they enable the economy to grow under its own force by removing impediments. One impediment would be that when somebody loses their job, they're not able to transition into another job easily, such as, for instance, the oil workers who were laid off in the course of the oil price decline. Investing more into that fluidity between sectors and the ability to, in effect, learn throughout one's career and throughout one's lifetime.... Many of us, such as our kids, are doing jobs that none of us ever imagined. How could we predict that and help them choose the right courses in university or whatever to prepare for that? These days it's more about preparing to be smart and adaptable than about learning specific things, and I think if companies were prepared to do more, under the right sorts of arrangements—on-the-job type of training or apprenticeship-type of programs in a wider array of fields—we could capitalize on smart people who are ready to adapt. We can't just rely on schools to give us turnkey resources in a world that's changing so fast.

I believe the kinds of tools that you talk about can be very important to releasing the capacity of the economy.

**Mr. Francesco Sorbara:** Thank you.

**The Chair:** Okay, with that, we will thank the governor, the senior deputy governor, and committee members.

The meeting is adjourned.