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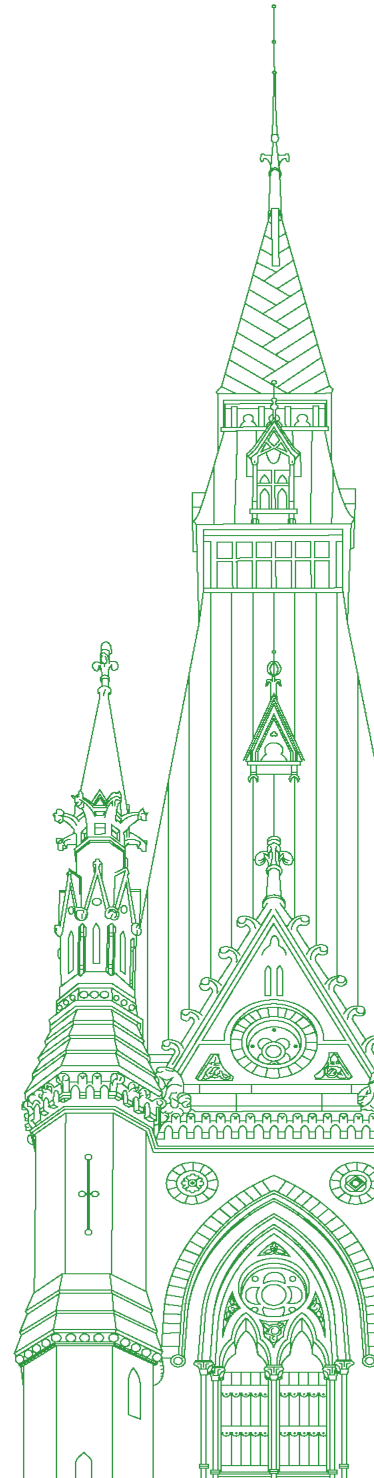

Chair: Mr. Peter Fonseca

Standing Committee on Finance

Thursday, May 2, 2024

• (0845)

[*English*]

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

Welcome to meeting number 141 of the House of Commons Standing Committee on Finance. Pursuant to Standing Order 108(2) and the motion adopted by the committee on Monday, November 21, 2022, the committee is meeting to discuss the report of the Bank of Canada on monetary policy.

Today's meeting is taking place in a hybrid format, pursuant to Standing Order 15.1.

Before we begin, I'd like to remind all members and other meeting participants in the room of the following important preventive measures. These have changed a little bit, members, through a message you would have received from the Speaker's office.

To prevent disruptive and potentially harmful audio feedback incidents that can cause injuries, all in-person participants are reminded to keep their earpieces away from all microphones at all times.

As indicated in the communiqué from the Speaker to all members on Monday, April 29, the following measures have been taken to help prevent audio feedback incidents.

All earpieces have been replaced by a model that greatly reduces the probability of audio feedback. The new earpieces are black in colour, whereas the former earpieces were grey. Please only use the approved black earpiece. By default, all unused earpieces will be unplugged at the start of a meeting. When you are not using your earpiece, please place it face down on the middle of the sticker that you will find on the table, as indicated. Please consult the cards on the table for guidelines to prevent audio feedback incidents.

The room layout has been adjusted to increase the distance between microphones to reduce the chance of feedback from an ambient earpiece. The measures are in place to allow us to conduct our business without interruption and to protect the health and safety of all participants, including the interpreters.

Thank you all for your co-operation.

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

Please wait until I recognize you by name before speaking. Members in the room, please raise your hand if you wish to speak. Members on Zoom, please use the “raise hand” function. The clerk and I will manage the speaking order as best we can, and we appreciate your understanding in this regard. I would remind you that all comments should be addressed through the chair.

Now I will welcome our witnesses. We have with us, from the Bank of Canada, Governor Tiff Macklem.

Welcome, Governor.

Joining the governor is the senior deputy governor, Carolyn Rogers. Welcome.

Just before we hear your remarks, we do want to thank you for the kind invitation to join you at the Bank of Canada for a tour and an informal conversation. On behalf of the members, we thank you for that.

Members, you should all have received the invitation from the governor.

With that, Governor Macklem, the floor is yours.

• (0850)

Mr. Tiff Macklem (Governor, Bank of Canada): Thank you, Mr. Chair. We are very much looking forward to hosting you at the Bank of Canada.

I am very pleased to be here this morning with the senior deputy governor, Carolyn Rogers, to discuss our recent monetary policy report, as well as the monetary policy decision we took at our last meeting.

In April, we maintained our policy interest rate at 5% and we published a revised outlook for the Canadian economy. We had three key messages.

First, monetary policy is working. Total CPI and core inflation have eased further in recent months, and we expect inflation to continue to move closer to the 2% target this year.

Second, growth in the economy looks to be picking up. We expect GDP growth to be solid this year and to strengthen further in 2025.

Third, as we consider how much longer to hold the policy rate at the current level, we’re looking for evidence that the recent further easing in underlying inflation will be sustained.

Before taking your questions, let me take a moment to discuss recent economic data and our outlook for growth and inflation.

[*Translation*]

In Canada, growth stalled in the second half of last year and the economy moved into excess supply. The labour market also cooled from very overheated levels. With employment growing more slowly than the working-age population, the unemployment rate has risen gradually over the last year to 6.1% in March. There are also some signs that wage pressures are beginning to ease.

Economic growth is forecast to strengthen in 2024. Strong population growth is increasing consumer demand as well as the supply of workers, and spending by households is forecast to recover through the year. Spending by governments also contributes to growth, and U.S. strength supports Canadian exports.

Overall, we forecast growth in Canada of 1.5% this year and about 2% in 2025 and 2026. The strengthening economy will gradually absorb excess supply through 2025 and 2026.

CPI inflation was 2.9% in March, and price increases are now slowing across most major categories. However, shelter cost inflation is still very high and remains the biggest contribution to overall inflation.

Looking ahead, we expect core inflation to continue to ease gradually. The more timely three-month rates of core inflation are well below the 12-month rates, suggesting some downward momentum. But with gasoline prices rising, CPI inflation is likely to remain around 3% in the coming months. It is then expected to ease below 2% in the second half of this year and reach the 2% target.

[*English*]

As always, there are risks around our forecast. Inflation could be higher if global tensions escalate, if house prices in Canada rise faster than expected or if wage growth stays high relative to productivity. On the downside, economic activity globally and in Canada could be weaker than expected, cooling demand and inflation too much.

We don't want to leave monetary policy this restrictive for longer than we need to, but if we lower our policy rate too early or cut too fast, we could jeopardize the progress we've made in bringing inflation down.

Overall, the data since January have increased our confidence that inflation will continue to come down gradually, even as economic activity strengthens. Our key indicators of inflation have all moved in the right direction, and recent data point to a pickup in economic growth.

I realize that what most Canadians want to know is when we are going to reduce our policy interest rate. The short answer is we are getting closer. We are seeing what we need to see. We just need to see it for longer to be confident that progress toward price stability will be sustained.

In the months ahead, we will be closely watching the evolution of core inflation. We remain focused on the balance between demand and supply in the economy, inflation expectations, wage growth and corporate pricing behaviour as indicators of where inflation is headed.

To conclude, we have come a long way in our fight against inflation, and recent progress is encouraging. We want to see this progress sustained.

● (0855)

With that summary, the senior deputy governor and I will be very pleased to take your questions.

The Chair: Thank you, Governor and Senior Deputy Governor.

I'm sure the members have many questions. As you know, we start with the first round of six minutes for each party.

We're starting with MP Hallan for the first six minutes.

Mr. Jasraj Singh Hallan (Calgary Forest Lawn, CPC): Thank you, Governor and Deputy Governor, for being here.

Governor, it's my understanding that each central bank sets its own interest rates. Is there a global interest rate that would impact a Canadian mortgage?

Mr. Tiff Macklem: Global interest rates do impact Canadian interest rates. Global financial markets are very integrated.

In Canada, obviously, we're very integrated with the United States, so the interest rates in the United States have an impact on us. Because we have our own currency and because we have a flexible exchange rate, we can run our own monetary policies. Our interest rates in Canada don't need to be the same as the U.S. rate or global rates, but there is a limit to how far they can diverge. We're not close to that limit. We have the ability to run our own monetary policy geared to what Canadians need.

Mr. Jasraj Singh Hallan: In that vein, we see in the U.S. that the U.S. Fed has held the rate. Yesterday the Prime Minister said interest rates would come down. When you do cut the rate—whenever that does happen—what kind of impact does that have on the Canadian dollar if the U.S. market stays the same and the U.S. holds their rate?

Mr. Tiff Macklem: The Canadian rate is already below the U.S. rate. We're at 5%. They're at 5.25% to 5.5%.

It's a little hard to say exactly what will happen on the day. It will probably, on balance, weaken the Canadian dollar a little, but a lot of it depends on expectations. If you go back a few months, the expectation in the market was that the Fed might cut before the Bank of Canada. That expectation has shifted. To some extent, that's already built into the markets, so yes, if we move lower than the Fed, that will tend to depreciate the Canadian dollar. That's partly how monetary policy works. A weaker dollar stimulates our exports, so monetary policy becomes less restrictive.

Mr. Jasraj Singh Hallan: The Prime Minister said yesterday, as I said, that interest rates will come down. He was sure of that, but his housing agency, CMHC, is also saying that housing starts last year, this year and next year will all decline. In fact, CMHC is saying that we need five million more homes on top of whatever is being built. The National Bank said, “Canadian households should not expect any significant relief from housing cost inflation.”

When you lower that interest rate, what impact is that going to have on housing prices, given that the demand has not gone down and is only increasing?

Mr. Tiff Macklem: The housing market is very sensitive to interest rates, and right now the policy rate, at 5%, is restraining demand. Obviously it is making the cost of a mortgage higher, which is restraining demand. If we lower interest rates, it will be less restrictive on housing and, other things being equal, housing will tend to be stronger than it otherwise would have been.

In our own forecast, we do have a pretty strong pickup in housing over the course of this year. We also have some increase in housing prices. We also expect that supply, while it isn't going to grow quickly, will be growing gradually, and so the gap will be narrowing, but I would agree that it's definitely going to take some time to close that supply shortage.

Mr. Jasraj Singh Hallan: Respectfully, Governor, I don't think you fully answered that. We already have a supply shortage in housing. We see a rise in demand. Isn't that correct?

● (0900)

Mr. Tiff Macklem: I agree. Yes, we have a supply shortage. There's no doubt.

Mr. Jasraj Singh Hallan: According to CMHC, housing affordability will not meet what Canadians expect today. According to what you just said, do you have a timeline? Given everything, all the numbers you have today, what kind of timeline are Canadians looking at for housing affordability to come back to what it used to be in Canada?

Mr. Tiff Macklem: Housing prices went up a lot throughout the pandemic. They went up 50% in two years throughout the pandemic. They came down about 15%. They're back up somewhat now, so they're net down about 10%.

We're not really in the real estate business, but our own forecast is that housing prices will continue to move up gradually, so I don't think you're going to see a big change.

Mr. Jasraj Singh Hallan: Is there a fear that a cut will increase demand further, which might also push up the shelter inflation?

Mr. Tiff Macklem: That is a risk. We do highlight that in our report. I think, in our own—

Mr. Jasraj Singh Hallan: Is that more of a possibility than not, given that housing starts are decreasing?

Mr. Tiff Macklem: In our forecast, as I said, we built in a fairly strong growth in housing activity throughout this year, and we built in some increase in prices. We took that risk on board in our base case projection. It could be even stronger than we expect, and that is a risk we highlighted.

I just add that the housing sector is an important part of the economy. It's an interest-sensitive part of the economy. It's certainly something we watch very closely, but we need to run monetary policy for the whole economy.

The Chair: Thank you, MP Hallan.

Now we'll have questions from MP Baker.

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

Governor and Senior Deputy Governor, thank you for being here at the finance committee again.

Governor, I'm going to ask you the question I ask you every time you come to committee. It's the question I get asked by my constituents in Etobicoke Centre more often than any question when it comes to your role as governor.

When are interest rates coming down?

As you know, and as we've discussed at this committee before, folks are struggling for a range of reasons right now. The cost of living is high. Housing prices are high. There are a lot of folks who have mortgages on a variable rate or they had a fixed rate and they've had to renew at a much higher rate. That's been very difficult for a lot of folks to bear. Some have had to move out of their homes. Some have had to make significant sacrifices to make those payments.

That's the underlying reason I'm asking this question. I'm wondering if you could do your best to share that with me and I will share your response with my constituents.

When are interest rates coming down?

Mr. Tiff Macklem: I appreciate that you are sharing the concerns and the perspectives of your constituents. We also survey Canadians. We do hear directly from Canadians, and that is an important input into our monetary policy decisions.

At our last meeting a couple of weeks ago, we did discuss when it would be appropriate to reduce our policy interest rate. As I outlined in the opening statement, we were certainly encouraged by the progress. We do see renewed downward momentum in underlying inflation. For a while, it had kind of stalled. We do see renewed downward momentum.

If you go back to what we said in January and March, we indicated then that we were looking for further and sustained easing in underlying inflation. What we concluded a couple of weeks ago was that we have seen further easing. What we're really looking for now is for assurance that it is sustained.

The message to Canadians is that we are getting closer. We are seeing what we need to see. We just need to be confident that it will be sustained.

We're very conscious that we don't want to keep monetary policy this restrictive for longer than we have to. On the other hand, getting inflation down as much as we have has been a hard-fought battle. We don't want to cut too early or too quickly and jeopardize that progress. We are trying to balance those two risks.

We're going to take our next decision on, I think, June 4. Then we have another one in July and another one in September. We take our decisions at the decision date, based on the best available information we have at the time.

I'm not going to predict what we're going to do at each decision. We'll do our best for Canadians when we get there.

● (0905)

Mr. Yvan Baker: I appreciate that.

When you say you're looking for signs that inflation is sustainably coming down before lowering interest rates, can you talk about what kinds of things you're looking at? What are the kinds of things that Canadians, like my constituents in Etobicoke Centre, should be looking at to believe that things are heading in the right direction or not?

Ultimately, they want to see you lower rates.

Mr. Tiff Macklem: That's a very good question.

The first point is that headline inflation—CPI inflation,—is probably going to bounce around from month to month. The latest reading is 2.9%. It will probably stay pretty close to around 3% for the next several months because we know global oil prices have gone up and gasoline prices have gone up. That has a very immediate effect on CPI.

We're looking to see, when you strip that out, that our measures of core or underlying inflation continue to move down. Watch CPI-trim and CPI-median. Those are our two preferred measures of core.

In practice, those are our preferred measures of core for good reason, but there are other measures of underlying inflation, like CPI excluding energy and CPIX.

In our monetary policy report, you'll see that there's regularly a chart of the proportion of CPI components rising faster than 3%. When inflation was 8%, that was as high as 80%. The latest reading is 38%. Normal is about 25%. We're not quite normal yet, but we're getting there.

We're looking for inflation to come down and for it to be less broad-based. We'll be trying to look through the volatile components in headline. We're focused on the underlying measures.

Mr. Yvan Baker: Thank you for that.

In your previous appearances here at the committee, we talked about fiscal responsibility and its role in cost of living and the broader economy. I saw that after the budget was tabled, you made comments at the IMF spring meetings, I believe, about the government's fiscal guardrails and how committing to those guardrails is helpful.

As we see core inflation continue to come down, can you expand on those comments about how Canada's fiscal position has not really changed since the budget was presented?

Mr. Tiff Macklem: I guess the first point to make is that the federal budget was tabled after our latest forecast, so it is not included in the latest monetary policy report. Most provincial governments tabled their budgets ahead of our monetary policy report, so they are included in the forecast. Also, a number of provinces increased deficit finance spending. That is reflected in our forecast. It increases the contribution to growth from governments overall. Increasing spending and fiscal deficits when we're trying to get inflation down is not helpful.

The federal budget, as I said, is not included in our forecast. We will update our forecast in July and include it. Looking at the federal government, what you see is that spending is also up, and this is largely matched by an increase in revenue. Revenue is higher because the forecast for growth is stronger—which generates more tax revenue—and because there are some new fiscal measures, the most significant being the increase in the inclusion rate on the capital gains tax. The combined effect of these is that the fiscal track—by which I mean the track of deficit to GDP and debt to GDP—has not changed significantly from a macro perspective since the fall economic statement.

Yes, we'll have to look at the various measures. Different measures have different fiscal multipliers. However, at a very macro level, there's more spending going into the economy and more tax revenue coming out of the economy. The net effect from a macro perspective probably won't be that big, so I don't expect it will have a material impact on our forecast.

● (0910)

Mr. Yvan Baker: Thank you.

Mr. Tiff Macklem: With respect to the guardrails, this—

The Chair: We may have to go to the guardrails later, Governor. We're well over time.

Mr. Tiff Macklem: Okay. I'm sure there will be more questions on fiscal policy.

The Chair: Who knows? MP Ste-Marie may be asking about guardrails.

MP Ste-Marie, the floor is yours.

[*Translation*]

Mr. Gabriel Ste-Marie (Joliette, BQ): Thank you, Mr. Chair.

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

I'm sorry, but our committee chair is very strict and does an excellent job managing our time.

I have some questions about the latest budget, but before we continue on that topic, I have a question for you.

You are often quoted by this committee for your analyses of the impact of the carbon tax on inflation. When you appeared before the committee on that topic last fall, you gave the example of Ontario. If possible, could you please provide the committee with the results of your calculations, for each province, regarding the impact of the carbon tax on inflation?

Mr. Tiff Macklem: We can certainly provide that information.

As you know, the various provinces have different policies and approaches to the carbon tax. In estimating the impact of that tax on inflation, we look exclusively at the three elements with the most direct impacts in each province. We then collate all of that data to arrive at an estimate for the country as a whole.

We can certainly provide the committee with our calculations for each province if you wish.

Mr. Gabriel Ste-Marie: Thank you very much. That information will be very useful.

I want to get back to the budget now.

From your answers to Mr. Baker's questions, I understand that the in-depth analysis of the impact of the federal budget on your monetary policy as a whole will be completed in July, but at first glance it seems the impact will be relatively neutral or similar to that of the fall economic statement, given that the deficit is offset by new revenues and that will be sustained. Is that correct?

Mr. Tiff Macklem: Yes.

Mr. Gabriel Ste-Marie: Later on, we will be voting on the ways and means motion in the House. We have started examining it, and the announced increase in the capital gains tax is not included. The day before yesterday, the Minister of Finance said that will be the subject of a separate bill.

If that increase is not presented, we can expect the budget to fuel inflation. Is that correct?

[*English*]

Mr. Tiff Macklem: It's a bit hypothetical.

[*Translation*]

That being said, if we remove a source of revenue, so the deficit will be larger and that will have a stimulative effect.

Mr. Gabriel Ste-Marie: Thank you.

I would like to move on to something else now.

I would like you to talk to us briefly about the importance of the Bank of Canada's independence in managing its policy, specifically in inflationary times.

We have seen the decision from the U.S. Federal Reserve. Analysts are saying though that Joe Biden is hoping to see interest rates drop before the end of the presidential campaign to increase his support in the polls.

Do you feel the same kind of pressure here? Various columnists are considering the possibility that the current Prime Minister might step down, that there could be a leadership race and that economic conditions might improve, specifically as a result of lower interest rates, perhaps by the summer. Do you feel that kind of pressure in your decisions?

I want to stress the importance of independent monetary policy.

Mr. Tiff Macklem: First, the answer is no. There is a good reason for having a central bank that is independent from the government: It is precisely to avoid that kind of situation.

Monetary policy does not have immediate effects in a fiscal cycle. It takes time and it is important to stay the course. That is precisely why big countries have an independent central bank.

So no, there is no pressure. I was very clear about that yesterday: Elections are elections, and monetary policy is monetary policy. Our mandate is clear and monetary policy will be managed to fulfill that mandate, period.

● (0915)

Mr. Gabriel Ste-Marie: Thank you for that information.

I would like to pick up on some of the conversation you had at the Senate committee with my colleague Clément Gignac. Although he is a senator, I can certainly see that he has other qualities. He pointed out that, up until the pandemic, your monetary policy and that of the U.S. Federal Reserve were pretty much in sync, but since the pandemic, we have seen a growing gap between the Canadian economy and the U.S. economy in terms of core inflation indicators.

Please tell us again about the possibility of having a monetary policy that differs from that of the U.S. Federal Reserve and explain how you take account of interest rate variations in that analysis.

Mr. Tiff Macklem: To begin, let me point out that our mandate and that of the U.S. Federal Reserve are similar, as are the two countries' economic situations. First and foremost, we experienced similar shocks during the pandemic. Monetary policy in the two countries was similar, but not exactly the same. As I said, the inflation rate was a bit higher in the United States, and their federal funds rate was a bit higher than the key interest rate in Canada. Broadly speaking though, it was quite similar.

More differences have emerged in recent months. As I told the Senate committee yesterday, it seems that monetary policy has more traction in Canada, and there are a few reasons for that.

First, it is probably because our mortgage market does not have the same structure as the American one. In the U.S., mortgages are typically for a 30-year term, while here mortgages are renewed every five years and sometimes even more often. More people in Canada have already renewed their mortgages, and those who have not done so will do so soon. Consumers know that their mortgage will have to be renewed, and they are probably saving more money for that.

Secondly, household debt is higher in Canada. So an interest rate hike has a greater impact on Canadian households, and that is reflected in GDP growth: Our GDP growth is weaker than that in the United States.

So it is not surprising that inflationary pressures are weaker in Canada. If the dynamics of our economies, and particularly the dynamics of inflation, differ between the two countries, so will our monetary policies.

The Chair: Thank you, Mr. Ste-Marie.

[*English*]

Now we'll go to MP Davies, please.

Mr. Don Davies (Vancouver Kingsway, NDP): Thank you, Mr. Chair.

Thank you, Governor and Deputy Governor, for being with us today.

Governor, in its most recent deliberations, the Bank of Canada's governing council listed corporate pricing behaviour as one of four key indicators of underlying inflationary pressures. In November 2023, in an article by the CBC, you were quoted as saying:

> When input prices have gone up...those are getting passed through much more quickly to final goods prices. So households are bearing the full inflationary impact much more: that's what we can see pretty clearly in the data.

In your view, Governor, why have increases in input prices been passed through to final goods prices more quickly in recent years than in previous decades?

Mr. Tiff Macklem: We've actually been doing quite a bit of work on this. Perhaps the senior deputy governor would like to comment on that.

Ms. Carolyn Rogers (Senior Deputy Governor, Bank of Canada): Sure. In fact, in our most recent monetary report, there is a box that goes into this in a fair bit of detail.

Directly to your question, I think the reason we saw companies were quicker and more inclined to pass through costs is that demand was high, so they were able to pass costs through and it wasn't affecting their sales. People were still paying.

When inflation is high, that is one of the dynamics we watch very closely. As inflation is coming down, demand is coming down and is more in balance with supply, and companies think carefully about whether they can pass through their cost increases.

● (0920)

Mr. Don Davies: Thank you.

In a February 2024 report, James Orlando, director and senior economist at TD Economics, said:

> The Bank of Canada’s inflation problem is mostly a housing issue. With shelter inflation accounting for more than half of overall inflation, this has become the biggest hurdle preventing the BoC from cutting rates.

Governor Macklem, do you agree with that assessment?

Mr. Tiff Macklem: I would agree that housing cost inflation is the biggest contributor to overall inflation, and it is an important factor that is holding inflation up.

Mr. Don Davies: On that point, Stats Canada says year-over-year inflation in March, excluding mortgage interest, was 2%. That's exactly the bank's target. Higher mortgage interest has added close to one full percentage point to CPI inflation since last May.

Is there something counterproductive in the Bank of Canada trying to reduce inflation by using a policy tool that is increasing inflation by close to a full percentage point?

Mr. Tiff Macklem: If we hadn't raised interest rates, inflation and everything else would be higher, and overall inflation would be higher. We are well aware that when we raise interest rates, this increases the cost of borrowing. That is impacting Canadians. In fact, that's how monetary policy works. It restrains spending to get inflation and everything else down.

The CPI includes mortgage interest costs. That is a major cost for households, so it should be in there. We're well aware that's the part of the CPI that we have the most direct effect on. When we raise rates, mortgage costs go up. Everything else being equal, that pushes inflation higher. In the conduct of monetary policy, we also know that when we reduce our policy interest rate, inflation will come down. That is something we can look through as we conduct monetary policy.

You'll notice we've talked a lot about how we're very focused on core inflation. One of the reasons for that is CPI-trim, which trims out the things that are going up the most and the things that are going down the most. It has systematically been kicking out or removing mortgage interest costs because they are up a lot. By focusing on core, we're effectively looking through the impact of mortgage interest costs on inflation.

The other thing I would say about our measures of core inflation, though, is that our two measures of core—one is 3.1 and one is 2.8—are still well above two. What that's telling you is that yes, if you just pull out the thing that's going up a lot, mortgage interest costs, what's left is going up much more slowly, roughly 2%. If you systematically take out the things that are going up and the things that are going down a lot, you're still well above 2%. That's what we're focused on: getting that down.

Mr. Don Davies: I wanted to raise some unintended consequences.

We know that high interest rates have prevented many Canadians from purchasing a property. Obviously, if mortgage rates are high, not as many people buy. People are telling me that this is keeping people in the rental market.

Would that demand for rental properties have anything at all to do with the rapid rise in rents?

Mr. Tiff Macklem: Yes.

There's a lot of pressure on rents. I would agree that there probably is some effect. With higher interest rates, people are delaying buying a house and they need to rent for longer.

I think the bigger effect, though, is that we have had a tight rental market combined with a big surge in immigration. Many of those immigrants are entering the rental market. We've seen a big increase particularly in non-permanent residents. That is putting a lot of additional pressure on the rental market. Rent inflation is around 8%.

Mr. Don Davies: Yes.

I think CMHC is clear in saying that supply is not forecast to keep up with demand, leading to higher rents and lower vacancy rates in the coming years. Would you agree with that assessment?

● (0925)

Mr. Tiff Macklem: I hope the gap narrows gradually, but yes, I don't think this situation is going to be resolved quickly. It's going to take some time to build new purpose-built rentals.

The other aspect that may take some pressure off is that, as you know, the government has recently announced that they are reducing the number of non-permanent residents coming into Canada. We have included that in our projections. It was announced ahead of the budget. That should take some of the demand pressure off.

Yes, it is difficult to forecast these things.

Mr. Don Davies: Thank you.

The Chair: Thank you, MP Davies.

Governor and Senior Deputy Governor, MP Davies is a new permanent member of our committee. We also have PS Turnbull here on our committee now.

We're in our second round, members.

We're going to MP Chambers for five minutes.

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

Governor, thank you for the work you do on behalf of Canadians. I appreciate your coming to committee.

When you were here about six months ago, we talked about fiscal and monetary policy. I believe you said that if the rate of growth in government spending could be at or below 2%, we would be good. Spending growth next year for the federal government is 6.7%.

I'm not steeped in economics and I always learn something from you every time you're here. I'm trying to understand how that is not inflationary pressure.

Mr. Tiff Macklem: Let me back up a little bit.

First of all, that 2% number I gave you is real government spending on goods and services. It's not nominal spending and it's not public accounts spending; it's the national accounts measure of government spending on goods and services. Those numbers aren't directly comparable.

What I can say in terms of our projection is that if governments are not increasing their deficits and government spending is growing around 2%, the potential output of the economy is growing about 2%, so government spending is not adding more to demand than supply is growing. It's roughly in balance—

Mr. Adam Chambers: I'm going to jump in right there, if that's okay. Expanding the deficit is expansionary fiscal policy. Is that correct?

Mr. Tiff Macklem: That is correct.

Mr. Adam Chambers: In the last year and a half, the government has added net, not gross, new spending of $100 billion to the fiscal framework. That's all deficit financed.

Is it your testimony that we are no longer in an expansionary fiscal environment?

Mr. Tiff Macklem: My testimony is that the fiscal situation.... Looking at this budget relative to the fall economic statement, the deficit-to-GDP and to the debt-to-GDP track have not changed significantly. I don't expect that there's going to be a significant macro impact relative to our previous forecast. In other words, I don't think that the federal budget is going to have a big impact on the forecast that we published a few weeks ago.

Mr. Adam Chambers: Would you say now that fiscal and monetary policy are rowing in the same direction?

Mr. Tiff Macklem: Coming back to our forecast, most of the provinces tabled their budgets ahead of the MPR. They did increase spending, and it was largely deficit financed. That has increased the contribution to growth from government. The last time I was here, I think I said that government spending on goods and services this year was forecast to grow at about 2.25%. That has now moved up to 2.75%. That is somewhat above 2%, so yes, that is not helpful in trying to get inflation down. This is built into our forecast, and we still get inflation back to the 2% target. It gets there gradually.

The final thing I will say is that there a number of risks to our forecast, and we highlight those in the back. To the extent that the federal government sticks to its fiscal guardrails, the risk on government spending is managed. I mean, we see some bigger risk to our inflation forecast coming from geopolitical events. Others have mentioned the housing market. We think those are bigger risks.

● (0930)

Mr. Adam Chambers: Thank you very much; that's very helpful.

I know you mentioned earlier that we could take a calculator and do it our ourselves, but I certainly appreciate the bank's model on how it's looking at government spending. You can understand how it's a little bit confusing.

I'll move on to my last question.

Mr. Tiff Macklem: We can talk to you off-line about that. To be honest, it is quite complicated.

Mr. Adam Chambers: That's very helpful, but I just have one more question, Governor.

All tax increases are not the same with respect to inflation. I'm trying to think about the capital gains tax, where you pull forward a bunch of transactions that would have happened in future years. Concerning that movement of money when someone turns an asset into cash and creates a big cash balance in a new person's bank account, is that not an inflationary pressure even just a little bit?

Mr. Tiff Macklem: As I said, we're going to have to go through the budget a little more carefully. On the spending side, there are a number of new spending initiatives, as you've highlighted. Those will have different types of fiscal multipliers. For example, military spending that is mostly buying imported U.S. machinery is not going to have much inflationary impact in Canada.

Mr. Adam Chambers: I'm out of time, but I will look forward to your capital gains explanation.

Mr. Tiff Macklem: I'm getting to capital gains.

All this is to say that we need to look at the various measures more carefully, and we will do that as we come to July.

My analysis at this point is very macro. There's more spending going into the economy and the government's tax measures are pulling more money out of the economy. From a macro perspective, the net effect isn't that big from an inflationary point of view.

Mr. Adam Chambers: It's pulling money out, but it's money that wasn't going to be brought out anyway, because the assets weren't going to be sold. That's a bit academic, but maybe we could talk about that offline.

Mr. Tiff Macklem: It's taking money out of the private sector and into the government.

The Chair: Thanks, MP Chambers.

We are going to MP Dzerowicz for the next five minutes.

Ms. Julie Dzerowicz (Davenport, Lib.): Thank you so much, Mr. Chair. I want to thank the governor and the senior deputy governor for being here today.

I'm going to start off with the residents in my riding of Davenport and what they and I are worried about.

You have been very consistent about how core inflation has to be sustained for a long period of time. You've come before our committee many times, and I've listened to a lot of your speeches. You've been very consistent.

What I worry about is that in living memory, my constituents remember a time when for 10 years interest rates were abnormally low. If you look at the whole span of history, you see that it was actually a very abnormal time period.

I feel that when we're talking about.... Whether you do it in June or whether you do it in the fall, if you start reducing interest rates, I'm worried that the perception that constituents in my riding and Canadians will have is that we'll be going back to what was an abnormal interest rate level for a long period of time.

Can you speak to that? Should they have that expectation, or should they be given a bit of a reality check?

Mr. Tiff Macklem: Look, we are concerned about that too. In fact, I think you gave a whole speech trying to outline the reasons that....

First of all, interest rates are certainly not going back to the low emergency levels we had during COVID, and they're unlikely even to go back to the pre-COVID levels. As you said, from the global financial crisis to COVID, we had an unusually long period of very low interest rates, so we're probably not going back to those types of interest rates.

The other thing I would say is that in our own forecast, once we become more confident that the downward momentum we've seen in core inflation is going to be sustained so that we are solidly on a track back to 2%, it will be appropriate to lower interest rates.

We're going to take decisions one at a time. When you look at our forecast right now, you see that inflation's coming down pretty gradually, so even when we start reducing interest rates, it's likely to be a pretty gradual path.

For both those reasons, in the longer term and the shorter term, I think Canadians should not be expecting that we will go back to pre-COVID levels of interest rates, and they shouldn't be expecting a rapid decline in interest rates.

Ms. Julie Dzerowicz: Thank you for that.

As you know, our government takes climate change seriously. We have a very strong climate plan to decarbonize and to move to net zero by 2050. In your last appearance at committee, you confirmed that the annual increases in carbon pricing would raise the average economy-wide price level by 0.1 percentage points, and you also said this is fairly negligible compared to other determinants of inflation.

What happens is that we say 0.1%, but Canadians don't really understand what that means. Does that mean $200 a month extra for them, or two dollars extra?

First, could you just confirm whether it is negligible, and second, maybe define it for the average Canadian who might not understand why 0.1 percentage points would be negligible according to StatsCan CPI calculations? Could you address that, please?

● (0935)

Mr. Tiff Macklem: I can follow up if you like with some more representative calculations, but yes, the government has laid out a schedule of increases to the carbon tax, and we can build those into our forecast. Also, yes, they have an impact of somewhere between 0.1 and 0.15 percentage points on inflation.

The latest reading for inflation was 2.9%. If the carbon tax had been held constant and not gone up, it would be closer to 2.8% instead of 2.9%. I can give you some representative calculations, but it's a small number.

Ms. Julie Dzerowicz: I just wish there was a way for us to say it, because when the Conservatives say it, that makes it sound like it's a big number, but when we say it, we say it's negligible because the governor says it's negligible.

Mr. Tiff Macklem: I'm not putting any adjectives on. Big, negligible, small, large—I'm just giving you a number. You can decide.

Ms. Julie Dzerowicz: No, but unless there is a way to actually further define it for Canadians, it's very hard to understand whether it's big or small.

I'll keep on going, Governor. My next question continues on the price on pollution, which we also call the carbon tax. The Conservatives have also argued that if we eliminate the carbon tax, or the price on pollution, it would bring inflation back within target. It would then lead you to cut rates, in turn easing the pain Canadians may be feeling.

Am I correct in saying that eliminating a price on pollution would not lead to price stability in the economy?

Mr. Tiff Macklem: It's always a little dangerous getting into things that haven't happened and things that could happen, but in general, if there is a tax change—if the carbon tax were to be eliminated—that would have a one-off drop on the price level. Inflation would drop for one year, and then after that it would go back to where it otherwise would have been.

You know, monetary policy needs to be forward-looking. We know that this a very temporary mechanical effect, so we would tend to look through that. If you want a good example historically, in 1994 the government cut the tax on cigarettes in half. There was a big smuggling problem and they needed to equalize it at the border. That had a big effect on inflation. Inflation was roughly 2% ahead of the tax cut. It went to 0% for a year, and then a year later it went right back up to 2%.

Now, from a monetary policy respect, once the tax cut is announced, you can see the impact on inflation. We know that a year later that will fall out, so effectively we look through that.

Ms. Julie Dzerowicz: Okay. Thank you.

The Chair: Thank you, Ms. Dzerowicz.

We will now move to MP Ste-Marie.

[*Translation*]

Mr. Gabriel Ste-Marie: Thank you, Mr. Chair.

Mr. Macklem, in your presentation you pointed out that you expect to see the consumer price index, and therefore overall inflation, reach 3% in the first half of the year, 2.5% in the second half and 2% in 2025.

You then talked about the importance of taking core inflation into account in your analyses.

Could the Bank of Canada start reducing its key interest rate before the CPI rate reaches 2%?

Mr. Tiff Macklem: Yes, and I have often said that.

It always takes a certain amount of time for interest rate changes to affect inflation. That is why we have maintained our predictions about inflation. When we are confident that we are on track to reach the 2% target, it will be time to start reducing the key interest rate. Monetary policy will remain tight, but not as tight as it is now.

We want inflation to stay around 2%. We do not want it to drop below that level. If we hold the key interest rate at 5% until inflation reaches 2%, the latter would probably fall below 2%.

● (0940)

Mr. Gabriel Ste-Marie: That is very clear, thank you.

In your presentation, you said twice that the economy is in excess supply. Is that correct?

Mr. Tiff Macklem: Yes.

Mr. Gabriel Ste-Marie: If there is excess supply, would that not be a good time to cut the key interest rate?

Don't you think your monetary policy is a bit too cautious?

Mr. Tiff Macklem: Everyone has their own opinion. In our opinion, the decisions we made were sound and that is why we made them.

We consider various indicators. Yes, the economy is in excess supply on the whole. In the second half of last year, growth was close to zero. So supply has caught up with demand and has even surpassed it now. That is one of the main reasons we are seeing less inflationary pressure.

We expect to see stronger growth this year than last year. Supply and demand will increase at roughly the same rate this year, while the output gap will remain essentially unchanged. Next year, we will see a drop.

Those are the inflation indicators we consider in predicting the direction of inflation. They are not the only ones though. We also consider wages, specifically with regard to productivity. We also consider inflation forecasts and the way businesses set their prices. All of these indicators are pointing in the right direction. Some are changing more quickly than others, but they are all going in the right direction. That gives us good reason to be confident that we are on track.

Mr. Gabriel Ste-Marie: Thank you.

The Chair: Thank you, Mr. Ste-Marie.

Mr. Davies, you have the floor.

[*English*]

Mr. Don Davies: Thank you, Governor.

I want to close off my question on housing.

It appears to be quite clear from the numbers that rental construction has declined since rates started rising. We know that interest rates are higher and that people aren't buying as many homes, but it also affects construction companies' decisions to build.

In your judgment, what has been the impact of higher interest rates on residential rental construction?

Ms. Carolyn Rogers: Higher interest rates are one of the costs that go into housing construction, so the rate of construction has been lower. There have been a number of incentives introduced to try to build back that construction activity.

Certainly, monetary policy has had an effect on housing starts. We have seen that.

Mr. Don Davies: Thanks.

I want to turn to unemployment.

In a speech in November 2022 to the Public Policy Forum, Governor, you said that Canada's unemployment rate, which was then 5.1%, was too low. Now it's 6.1%. Is unemployment too low today? What is your unemployment target? How high does unemployment have to go before you think it's too high?

Mr. Tiff Macklem: Let me first be very clear: We don't have an unemployment target; we have an inflation target. Our mandate is to control inflation.

We look at the labour market, really, through two lenses. The labour market is an important indicator of the degree of excess demand or excess supply in the economy. When I made those comments, the economy was clearly very overheated. The labour market was overheated. There were widespread reports from businesses that they couldn't find the labour they needed. Wage growth was picking up. Those are all signs that the labour market was out of balance.

Since then, the unemployment rate has risen from 5.1% to 6.1%. In practice, we look at a broad range of labour market indicators. On our website, we have this all laid out in quite some detail. You want to look at vacancy rates, the employment rates and the participation rates. You want to look at men, women and youth. When you look at them all together, what you see is a labour market that has certainly moved into better balance.

We're also starting to see wage growth—which has been too high, relative to productivity—start to moderate.

Those are all signs that inflationary pressures should be coming down.

● (0945)

Mr. Don Davies: You anticipated where I'm going next; I want to talk about productivity.

Deputy Governor, you said, according to a CBC article, that if Canada's recent productivity record is compared with that of other countries, what really sticks out is how much we lag on investment in machinery, equipment and intellectual property.

I've done some research. Spending on machinery and equipment by businesses, and on R and D and innovation, has been falling as a share of GDP in Canada for many years, dating back to the beginning of this century, after the corporate tax cuts that Paul Martin introduced. It's kind of ironic, because those corporate tax cuts were supposed to spur more business investment, not less. Even though we have rapid job creation and population growth, business capital investment has not kept up.

The C.D. Howe Institute did a comparison of the U.S. and Canada. In 2014, investment per worker in the U.S. was $20,700. It was $14,400 in Canada. In 2023, the U.S. has gone up to $27,800. We're at $14,500. We've gone up $100 in 10 years.

Could you outline what strategies could be more effective in increasing capital investment in Canada, given that the entrenched trickle-down theories, like tax cuts for corporations and the wealthy, clearly haven't worked as intended?

The Chair: MP Davies, that's a great question, but I need a super-short answer. We're well over the time, but there may be more opportunity in the final round to follow up on that. If you want a condensed, 20-second—

Ms. Carolyn Rogers: I can be quick.

You've outlined the problem very well. You've been clear that it has stretched over time, that it has stretched over different tax regimes. That tells us that there isn't a single, clear solution. There isn't a magic measure that's going to fix this. It's going to take more than one thing.

We're not tax experts. We're not even productivity experts.

I'll leave it there, Mr. Chair. I'm sure we'll come back to it.

The Chair: I'm sure you'll be able to elaborate in the next round, but we're going to MP Morantz now for five minutes.

Mr. Marty Morantz (Charleswood—St. James—Assiniboia—Headingley, CPC): Thank you, Mr. Chair.

Governor, it's always a pleasure to see you.

I'm going to ask you a pretty straightforward question. If inflation today was 2.1% or 2.2% instead of 2.8% or 2.9%, would that make your job easier in terms of a decision to reduce the policy rate?

Mr. Tiff Macklem: If we thought it was going to be sustained at that level, absolutely, yes, it would.

Mr. Marty Morantz: Earlier in this meeting you testified that the incremental increase in the carbon tax from $65 to $80 represented 0.1% of inflation and that if it hadn't happened, inflation would be 2.8%.

Is that correct?

Mr. Tiff Macklem: That's correct.

Mr. Marty Morantz: When you were here in October, you testified that the overall effect of the carbon tax at $65 a tonne was 0.6% of inflation.

Is that correct?

Mr. Tiff Macklem: That's correct.

Mr. Marty Morantz: The combined effect today, to be absolutely clear, is that at $80 a tonne, the carbon tax contributes roughly 0.75% to inflation.

Is that correct?

Mr. Tiff Macklem: That's not quite accurate.

What matters for inflation is the increase in the carbon tax. That's the 0.1% to 0.15%.

You are correct that if the carbon tax was eliminated, there would be a drop in the price level of about 0.7%, so for one year, inflation would be 0.7 percentage points lower.

Mr. Marty Morantz: On that talking point about one year, I want to correct that as well. It's one year in perpetuity. You can only eliminate the carbon tax once.

My question to you is fairly simple.

If the carbon tax were repealed—which is what Conservatives will do when we are in office—and it were repealed in April, would that have been helpful in your decision to reduce interest rates and as a result help millions of mortgage holders in Canada reduce their payments?

Mr. Tiff Macklem: As I said before, and as you just said, if you eliminate the carbon tax, you can only do that once, so it will drop inflation for one year, by our estimate, by about 0.7%.

A year later, inflation will go back up 0.7% because the one-off decline in the price level will fall out of the rate of change calculation.

In terms of monetary policy, we have had tax changes like this in the past. I mentioned the cut in cigarette taxes in 1994. Changes in GST have a similar one-year effect. Those are things we tend to look through.

In fact, one measure of core that we typically follow is something called CPIX-FET—food, energy and taxes—for exactly that reason. What we're focused on is the underlying trend in inflation.

This conversation is a little hypothetical, but—

● (0950)

Mr. Marty Morantz: I'm really sorry. I have limited time.

Could you just answer the question?

If the carbon tax were eliminated, would it make your job easier in terms of reducing tax?

Mr. Tiff Macklem: Inflation would be lower for one year, but it would not be sustainably lower, so I don't believe it would have a big impact.

Mr. Marty Morantz: Okay.

I want to circle back to this issue of the delta between.... I realize you said we have flexible monetary policy in Canada, but there is a limit, as you said yourself.

How big can the delta be? We already have a weak dollar at 72¢. It's way too low.

I just had a meeting last week, for example, with the Canada Foodgrains Bank in Winnipeg. All their contracts are in U.S. dollars. They feed the poor in countries all over the world, so this has real-life impacts on people. The value of the Canadian dollar has life-or-death impacts. That's just one example.

How far are you willing to go to jeopardize the value of the Canadian dollar?

Mr. Tiff Macklem: Look, our flexible exchange rate works well. It's what allows us to run monetary policy that is geared to Canadians. I'm not going to draw a line in the sand.

Clearly, if we cut interest rates and that weakens the Canadian dollar, that is something you take into account with how much you need to reduce interest rates to get the same amount of monetary policy stimulus.

It is certainly something we're going to take into account, but the whole reason we have a flexible exchange rate in our own currency is so that we can gear monetary policy to the needs of Canadians. We intend to use that system to the benefit of Canadians.

The Chair: Thank you, MP Morantz.

Now we are going to MP Thompson for the next five minutes.

Ms. Joanne Thompson (St. John's East, Lib.): Thank you.

Welcome back to the committee.

Thank you for the clarification on the pollution pricing and the carbon rebate. I cannot call it a tax.

I would like to stay on climate change, if I could. I believe it was my topic the last time you came to committee as well.

Given that climate change is becoming an increasing force or a major factor in the economy, and that this can also lead to increased supply disruptions, I would like to focus on this for a moment. In previous appearances, you stated that you were working on building a model on the effects of climate change into your main macro models or economic models.

Has there been any progress on this front? If so, I would be quite interested in hearing.

Ms. Carolyn Rogers: Yes, we are continuing our work on that.

One of the difficult things about using models for climate is that most of our models that help us forecast are based on history. The difficult thing about climate change is that we really don't have that kind of data from history to use. What the Bank of Canada and other central banks are doing is making good use of scenario planning, looking at different scenarios and using some of the climate science data to project what a future effect would look like.

We are going through a large exercise at the Bank of Canada right now, looking at our models. We're taking on board a lot of the things we've learned over the last few years. It's been a challenging time for central banks' ability to forecast, for a variety of reasons. One thing that we're really working hard on is trying to incorporate the effects of climate risk on the macroeconomy.

● (0955)

Ms. Joanne Thompson: Could you speak with a little more detail on what those climate risks are or what that looks like?

Ms. Carolyn Rogers: A big one is supply shocks, as you said. That would be one element. We look at transition risks, changes in relative asset prices. Those would be two good examples.

Mr. Tiff Macklem: There are roughly two types.

There are physical risks, such as flooding and forest fires. Obviously, those have very direct impacts on people and their livelihoods. They also disrupt transportation.

Then, as the senior deputy governor said, there are transition risks. We'll have less use of fossil fuels. We'll have a lot more electricity. That's just one example. There are some big adjustments that need to take place. How will those play through in the economy?

Ms. Joanne Thompson: Thank you.

Very quickly, again on risk, in your opening remarks you mentioned that one of the variables in terms of the economic forecast is global uncertainty. Could you speak briefly about the uncertainty in projections in terms of the real variables?

We tend to be very micro when we talk about it here at committee. I'd be interested in your thoughts.

Ms. Carolyn Rogers: The geopolitical risk usually translates into changes in assets that are priced globally. That's a lot of the commodities. The increase we've seen recently in oil is as a result of some of the geopolitical tension we have in the Middle East right now. That would be one risk.

The other way it would translate could be supply disruptions. If you have disruptions to trade agreements, that can have big effects on supply and on prices as well.

Ms. Joanne Thompson: Thank you.

I'll share some of my time with my colleague, who would like to add a point to her questions.

Ms. Julie Dzerowicz: Thank you, Joanne.

Governor, you very kindly offered to follow up with calculations when I was thanking you. If you could give us a little bit more detail around the annual increase from carbon pricing being around 0.1%, we would be very grateful.

Mr. Tiff Macklem: I'd be happy to.

Ms. Julie Dzerowicz: Thank you.

That's it.

The Chair: Okay.

Ms. Thompson, you still have 30 seconds. Do you have a quick question?

Ms. Joanne Thompson: I do have a quick question.

I'd go back to the reference to guardrails. I don't think you ever had the opportunity to expand on that. I think it's important in terms of understanding your comments on outlook and where Canada sits in terms of our economic forecast.

Mr. Tiff Macklem: Well, I think I was largely done, but in terms of the guardrails in particular keeping the deficit and the debt on a downward track, I think it's been very helpful to put not only a number on it but also a date. A target with a date by which you have to achieve it becomes a more meaningful target.

On the objective to have the deficit-to-GDP ratio declining and being below 1% in 2026-27 and thereafter, I think that this commitment is helpful in that it gives some clarity about the overall path for fiscal policy. From a monetary policy point of view, I think it mitigates the risk that large government spending will throw recovery from inflation off track.

The Chair: Thank you.

Thank you, MP Thompson and MP Dzerowicz.

Members, after looking at the time, I'll say that we're going to divide what time we have left equally. We're going to go with four minutes for each of the parties.

We're starting with MP Lawrence for the first four minutes.

Mr. Philip Lawrence (Northumberland—Peterborough South, CPC): Thank you very much.

Thank you, Governor Macklem, for being here and for your availability.

Who sets the interest rates for Canada?

Mr. Tiff Macklem: The governing council of the Bank of Canada.

Mr. Philip Lawrence: Right. Are you supposed to do that independently?

Mr. Tiff Macklem: Yes.

Mr. Philip Lawrence: At the end of question period yesterday, Prime Minister Trudeau said, “and interest rates will be coming down, I am sure, in the coming months.” Have you communicated to the government that you will be reducing interest rates?

Mr. Tiff Macklem: I have regular conversations with the Minister of Finance, but no, I don't.... We take our decisions when we take our decisions, and I communicate those decisions to the Minister of Finance after we've taken them.

● (1000)

Mr. Philip Lawrence: There's no way that the Prime Minister could know that interest rates are coming down.

Mr. Tiff Macklem: We haven't taken the decision yet, so....

Mr. Philip Lawrence: There's no way he would know that interest rates are coming down.

Why would he say that?

Mr. Tiff Macklem: I think you should ask the Prime Minister that question.

Mr. Philip Lawrence: I think we will. I think that's exactly what I'm going to ask.

Don't you think it's an irresponsible comment for him to make?

Mr. Tiff Macklem: I think you should take this up with the Prime Minister. I'll leave it at that.

Mr. Philip Lawrence: Okay.

I'm going to switch gears and talk briefly with Ms. Rogers, if that's okay, about productivity.

I agree with what you said in your speech on March 26, when you said this is a break-the-glass moment. I want to talk about one particular factor. I know there are many. You talked about it a bit in Canada and you talked a bit about it in your speech.

You talked about capital investment and the lack of it. Canada is, of course, predicted to be dead last in the OECD. We need capital to maintain, increase and improve our productivity, to grow our economy and to fight inflation.

Is now the time to increase taxes on capital?

Ms. Carolyn Rogers: As MP Davies pointed out, we have seen declining capital investment over a long period of time and over multiple different tax regimes. We're not tax experts, so we're not going to evaluate any one particular measure.

What I would say is that there are really three things that go into productivity. There's labour and there's capital intensity, and then there's a multiplier in terms of how effectively we use those other two things. Our productivity problem spans across those things. Capital intensity, capital investment is one of those things, but we have room to improve in all three areas.

Mr. Philip Lawrence: Yes. It makes sense, though, that presumably some of the issue, I think, is competition. Otherwise, why is that investment not being used by businesses? I think Mr. Davies makes that point well.

However, if in fact we reduce the amount of pie and we take more money from the private sector and give it to the public sector, and if Canadian businesses then have less investment and less capital, we're going to be less productive. That's just basic economics.

Ms. Carolyn Rogers: Is that a question?

Mr. Philip Lawrence: Yes, or it can be a statement. You could disagree or agree.

I'm sorry. Go ahead.

Ms. Carolyn Rogers: At a basic economic level, that's true.

As I said, there are three things that go into productivity, and we have room to improve on all three. I talked about all three of them in the speech. Investment is one area.

Mr. Philip Lawrence: Another issue that you talked about in your excellent speech, Ms. Rogers, is the difference in cultural or societal entrepreneurial spirit. Experts have commented that Americans seem to have more of that than Canadians.

One of the things I'm very challenged by with this NDP-Liberal government is their demonization of entrepreneurs and of success and of business owners. If in fact you hear things like “business owners are cheats” and you hear more and more of this class warfare, eat-the-rich type of commentary from the NDP-Liberal government....

I'm not worried so much about those who are already prosperous, but what I am worried about is those who desire to be wealthy, and I don't think being wealthy is a bad thing. In fact, I think it's a great thing.

If in fact we undermine young Canadians' dreams to become wealthy and to become successful, do you not believe that it has the effect of undermining our productivity?

Ms. Carolyn Rogers: I think Canada has a lot of entrepreneurial spirit. We have a strong education system. We have a lot of the factors that should set us up well to improve our productivity. I'll leave it at that.

The Chair: We'll go now to Mr. Turnbull.

Mr. Ryan Turnbull (Whitby, Lib.): Thanks to the governor and the deputy governor for being here today. It's good to see both of you.

I want to pick up where my colleagues left off and ask about climate change and the impacts on our economic growth. Do we have any idea, at this point, of the impact that climate change is having on Canada's economic growth?

I would note that the Canadian Climate Institute did a really good report called “Damage Control” that modelled this, and the numbers were pretty scary, to be honest, but I want to ask you, Ms. Rogers.

Ms. Carolyn Rogers: As I said earlier, one of the difficult things about climate change is that we don't have a long period of history from which to forecast events and the impact on the economy from events. It's really what we think of as shocks, and they can have an effect on growth.

If you looked at GDP in British Columbia, you saw the effects of the forest fires last summer very directly. In order to really think about the effects on the economy, you have to sort of forecast what we anticipate some of those shocks to be, how much more frequent they'll be, what the scale will be and those kinds of things.

● (1005)

Mr. Ryan Turnbull: Is the challenge not really having climate science integrated enough in your macroeconomic models?

Ms. Carolyn Rogers: One thing we're working on is trying to take what we've learned about the impacts of these shocks and forecast them on a go-forward basis.

The Chair: Excuse me for having to interject here, members and witnesses. The bells are ringing. I'm just looking for UC so that we can continue.

Some hon. members: Agreed.

The Chair: Okay. We have UC. Go ahead.

Mr. Tiff Macklem: I'm just going to underline that typically we have an economic model and we estimate it on historical data. For example, we've raised and lowered interest rates many times, so we can empirically estimate that if we raise interest rates, this is what it does to the economy, and if we lower interest rates, that's what it does to the economy.

We haven't had climate change before, so it's very hard to come up with good estimates, and if anybody says that they have a forecast of exactly what the cost is going to be, frankly, I think you'd want to be a little bit skeptical. Probably the best we can do is provide some scenarios and give some range of the costs. We are working on that, but it is somewhat outside of the way we normally do things, because we normally use past fluctuations to estimate what we think will happen again.

Mr. Ryan Turnbull: I understand that the climate risks and the frequency of those extreme weather events are hard to predict, because they haven't happened in the past as frequently. Certainly climate change is not a new story today; it's been going on for 30 or 40 years or longer.

I guess what I'm trying to get at is that there's quite a lot of international focus on the fact that climate change, in fact, threatens our economic stability, so I want to ask you about that. In your role, how are you thinking about how we mitigate that risk from an economic stability perspective?

Mr. Tiff Macklem: Just to be clear, the Bank of Canada does not have a mandate for climate policy. Our mandate is solely monetary policy, controlling inflation and trying to mitigate vulnerabilities in the financial system.

Climate change is a huge force on the economy. It's going to affect the economy. It is already affecting the economy. What we're focused on is working out the implications of that for inflation and what that means from a monetary policy. We're not in the business of trying to estimate the overall impact of climate change on the welfare of Canadians.

Ms. Carolyn Rogers: One thing I would add is that if you think of climate risk as the risk of shocks to the economy, you can create more buffers, so in the financial stability world, we're asking financial institutions to hold capital or buffers against those types of risks at a broader economic level.

This is one of the reasons we think productivity needs to be a focus. The more productive the economy is, the more buffer it has to shocks, including climate risk shocks.

The Chair: Thank you, Mr. Turnbull.

We'll go now to MP Ste-Marie, please.

[*Translation*]

Mr. Gabriel Ste-Marie: Thank you, Mr. Chair.

The key interest rate is 5%. What would the bank consider a neutral rate?

Mr. Tiff Macklem: Yes, we have estimates of a neutral rate.

I would like to emphasize that this is a theoretical concept. The neutral rate is the same as the key interest rate in a balanced economy, when the output gap is zero, inflation is at 2% and there are no economic shocks.

● (1010)

Mr. Gabriel Ste-Marie: What would that rate be?

Mr. Tiff Macklem: The only thing that is certain is that it will never happen because there will always be new shocks.

It is a concept. We have to put something in our model and, in the interest of transparency, we publish our neutral rate estimates. Once a year, we update our neutral rate estimates and the potential rate of economic growth.

Compared to our last report, our neutral rate estimate is now 25 base points higher. It is in the range between 2.25% and 3.25%, with 2.75% being the midpoint.

I want to be clear that it does not have much impact on our monetary policy decisions from year to year. It is actually a concept that applies in the longer term. In the short term, we focus mainly on the measures we have already discussed.

Mr. Gabriel Ste-Marie: Okay, thank you.

How many months has it been since your first rate hike to fight inflation? How many months ago was it?

Mr. Tiff Macklem: I don't understand your question.

Mr. Gabriel Ste-Marie: How many months has it been since your first hike in the key interest rate?

Mr. Tiff Macklem: I think the last rate hike was last July.

Mr. Gabriel Ste-Marie: I mean the first one, not the last one.

Mr. Tiff Macklem: The first rate hike was in March…. It was about 18 months ago.

Mr. Gabriel Ste-Marie: Okay.

I want to quote the economist Barry Eichengreen, from the University of California, Berkeley. He noted that, in the past, big price increases made it easier to manage inflation. By way of example, he said that certain periods taught us the importance of preserving the independence of central banks. So that lesson was learned from periods of managing inflation. He went on to say that we also learned that it is essential for central banks to establish a hierarchy of policy priorities and to communicate those priorities to financial markets and to the public. Those are some lessons gleaned from highly inflationary periods.

Are you already seeing a lesson emerge from the current inflationary period?

Mr. Tiff Macklem: Barry Eichengreen is an economist who examines history.

I wrote an article about that recently that was included in a publication by the Centre for Economic Policy Research. I also gave a few speeches on the topic, near the end of last year. It was about the lessons learned from the recent inflationary period. A whole chapter is devoted to that. It would be too long to describe, but there are a few important lessons.

One of those lessons was noted by the senior deputy governor: When there is excess demand in the economy, supply shocks have a greater impact. We have had supply shocks in the past 20 years, but in most cases the effects were "temporary". I want to stress the word "temporary". When we saw that that the shocks continued, we thought initially that they were temporary. But since there was excess demand in the economy, we saw that those shocks were having a much greater impact on inflation than in the past. That is one of the lessons we learned.

I think there is another lesson that is probably even more important. It is not really anything new, but something new that many Canadians had to experience, unfortunately. There had not been major inflation for many years, since the 1970s and 1980s. For many Canadians, it was truly the first time they had experienced inflation. So it is not a new lesson, but we observed once again that Canadians do not like inflation. It creates a lot of divisions and makes it look like the system isn't working. Canadians work hard, but their wages are not going as far as they used to.

● (1015)

The Chair: Thank you, Mr. Ste-Marie.

[*English*]

Thank you, Governor.

We are going to MP Davies. You'll be our last questioner, MP Davies.

I just want everybody to hold tight, because then we're going to have to transition to our other meeting. Everybody can stick to their desks.

We have MP Davies now, for four minutes.

Mr. Don Davies: Thank you.

Ms. Rogers, I realize you're not a policy source for how to deal with productivity, but you did raise, in a very profound and important way, the issue of productivity in Canada.

I want to press something. I was asking about the relationship between the policy of corporate tax cuts that were supposed to spur more business investment. In your answer, you said that this problem has persisted through different tax regimes. For the last 20-plus years, the policy in Canada on corporate tax rates has been to keep them low or to reduce them. There has been no reverse policy of increasing corporate tax rates.

Would you agree with me that one thing we can probably predict is that a long-term policy of low corporate tax rates has not proved particularly effective in incentivizing businesses to invest in R and D, innovation and technology?

Ms. Carolyn Rogers: I think what I would be inclined to agree with is the first part of your statement, that this has persisted over a long period of time in different regimes.

Mr. Don Davies: It's the same tax policy.

Ms. Carolyn Rogers: Again, we are not tax experts. It's not our job to evaluate the effect of tax policies.

Mr. Don Davies: Thank you.

Governor, I want to talk about gasoline prices for a moment. They've spiked in recent weeks in most parts of Canada, for several different reasons. Can you estimate the impact of these higher gas prices on year over year CPI inflation for April and May?

Do you think that higher gasoline prices are a reflection of excess demand in Canada's domestic economy? Will interest rates in Canada bring down the price of gasoline?

Mr. Tiff Macklem: The short answer to the second part of your question is no, I don't think this reflects excess demand in Canada. I think this largely reflects the global price of oil, particularly given the tensions in the Middle East. This is creating uncertainty in global oil markets. You've seen the global oil prices go up, and that is reflected very quickly in gasoline prices at the pump.

In terms of the contribution that this is likely to make for inflation, the increase in gasoline prices is really why we think headline inflation is going to remain around 3% for the next several months, even as we continue to expect underlying or core inflation that strip out those volatile components to continue to gradually tick down, as we have seen it do in recent months.

Obviously, at the end of the day our target is total CPI inflation. That reflects the cost of living for Canadians and that's what we're committed to getting back to 2%. Global oil prices can be volatile. They go up and down with geopolitical events and other events, so we tend to look through those and focus more on underlying inflation.

In terms of the message to your constituents, we're really focusing on looking for that continued gradual downtick in core inflation.

The Chair: Thank you, MP Davies.

On that, we want to thank Governor Macklem and Senior Deputy Governor Rogers. Thank you for coming before us with your report from the Bank of Canada on monetary policy and answering the many questions from our members.

Members, the governor and his office have sent out an invitation. Can you RSVP back to the governor? That is for us to tour the Bank of Canada in June.

Thank you, Governor. We wish you the best for the rest of your day.

Mr. Tiff Macklem: Thank you. Thanks for the opportunity.

We look forward to seeing as many of you as possible at the Bank of Canada.

The Chair: Thank you.

Members, we are in a suspended mode right now.

[*Proceedings continue in camera*]

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