

# Bank of Canada governor defends surprise interest rate cut

By Andy Blatchford

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Stephen Poloz stood on an international stage Thursday and defended his surprise January decision to cut the Bank of Canada's key interest rate.

The central bank governor used a speech in London to justify a move that shocked markets, stressing the urgency to react to the stunning speed and magnitude of the oil-price shock.

Poloz acknowledged he was well aware dropping the overnight rate would catch everyone off guard.

"We knew at the time that financial markets would be surprised by the move in January, and we generally prefer to avoid surprises," Poloz said in his address to the Canada-United Kingdom Chamber of Commerce.

Observers have questioned the decision, with some suggesting the central bank's integrity may have taken a hit as a result. Poloz appeared to respond to critics in the speech, arguing the central bank's credibility remained intact.

He continued by saying bouts of increased volatility should be expected as the world emerges from the Great Recession, abandons unconventional policy tools — like forward guidance — and returns to a normal trading environment.

Poloz described the bumpy reaction of financial markets to this kind of economic uncertainty as natural and "not an erosion of central bank credibility."

The central bank slashed its rate for the first time in years to 0.75 per cent from one per cent. It argued the move would provide "insurance" for Canada's oil-exporting economy amid plunging crude prices.

On Thursday, Poloz reiterated — this time for a foreign audience — his explanation that the cut was a way to buy the bank time to assess the

evolving economic impact of the oil-price plunge.

"We thought that it would be best to act sooner rather than later," Poloz said in his speech, titled "Central Bank Credibility and Policy Normalization."

"This (oil-price) shock, of course, surprised everybody, and the fact that it is so large and happened so quickly means that many of us have had to work hard to fully grasp all of its implications."

He said the negative impacts of the oil slump are starting to appear in the country's economic data, while the offsetting positives, tied to factors such as the lower Canadian dollar and the strengthening U.S. economy, will take longer to emerge.

Since the rate cut, Poloz said inflation has declined as the bank expected. He also said financial conditions have eased and crude prices have stabilized in a range "reasonably close" to the bank's January predictions.

"This made us feel increasingly comfortable with the amount of insurance we had already taken out," he said, explaining why the bank decided to hold the rate steady earlier this month.

One expert told his clients Thursday that this remark likely signals Poloz will avoid another rate cut at the Bank of Canada's next policy announcement, scheduled for April 15.

However, National Bank senior economist Krishen Rangasamy remained unsure of what to expect from Poloz.

"As we've seen before, the (Bank of Canada's) comfort with the economic situation can change quickly in response to updated data such as oil prices or employment," wrote Rangasamy.