Negative rates among Bank of Canada's potential tools to deal with future economic shocks

By Barrie McKenna
December 9, 2015 – *The Globe and Mail*

The Bank of Canada is giving itself a host of new, unconventional monetary tools to deal with possible shocks to the economy, including targeted infusions of credit into troubled sectors and pushing its key interest rate well below zero.

Governor Stephen Poloz rolled out the central bank's planned defences against future financial crises in a speech Tuesday in Toronto and in a "framework" posted on its website.

Mr. Poloz insisted that the timing of the announcement does not mean the bank is preparing to use any of these measures, even as the country deals with the aftershocks of the collapse in the price of oil and other commodities.

"We don't need unconventional policy tools now, and we don't expect to use them," Mr. Poloz said in remarks prepared for a speech to the Empire Club of Canada. "However, it's prudent to be prepared for every eventuality."

Among the measures, Mr. Poloz said the bank could now set its benchmark interest rate as low as minus 0.5 per cent, or below its previous floor of 0.25 per cent.

Mr. Poloz also rejected the notion that the global economy is stuck in a period of "global stagnation," brought on by an aging work force, and rendering central banks "powerless" to stimulate demand.

"I take issue with the word, stagnation," he said. "Growth has been slow, but it hasn't been non-existent."

Former U.S. Treasury Secretary Lawrence Summers is among the most vocal proponents of the secular stagnation theory.

Mr. Poloz agreed that growth in the developed world is likely to be slower now than in the previous decade. But he said technological change and freer trade have the power to counter demographic trends.

Mr. Poloz did acknowledge that monetary policy has its limits when interest rates reach ultra-low levels. And he said government spending is typically a better option for stimulating an economy facing conditions such as the Great Depression of the 1930s.

"Fiscal policy tends to be a more powerful tool than monetary policy in such extreme circumstances," he argued.

The new Liberal government is vowing to spend billions on infrastructure projects to help kick-start the economy and will go into deficit for at least two years to pay for the spending boost.

The plunge in the price of crude, now at $38 (U.S.) per barrel, is complicating the Canadian economy's recovery from a stall earlier this year, while depressing government tax revenues. That has pushed the dollar below 74 cents this week.

In spite of the resource slump, Mr. Poloz insisted that the economy still remains on-track to get back to regain full capacity "around mid-2017." That hasn't changed since the bank released its most recent economic forecast in October.

"The lower Canadian dollar and the interest rate actions taken earlier this year are working and it will be some time before we see their full impact," he said. "The overall economy is growing again, even as the resource sector contends with lower prices, because the non-

resource sectors of the economy are gathering momentum."

He acknowledged that Canada's recovery is "taking longer than we imagined back in 2008," he said.

The bank's new guidelines for using unconventional monetary tools updates a framework it introduced in April, 2009, as the global financial crisis still raged.

The central bank said it would be willing to make large-scale purchases of assets, such as government bonds or mortgage-backed securities – so-called quantitative easing. This has been used extensively by central banks in the U.S., Europe and Japan, but not so far in Canada.

The other key monetary tool the Bank of Canada would use is explicit "forward guidance" on where its key rate is headed – a measure that tends to push down longer-term market interest rates. In 2009, the bank promised to keep the overnight unchanged for at least a year.

In a question-and-answer session with the luncheon audience after the speech, Mr. Poloz acknowledged that the bank's new estimate of how far it could push interest rates into the negative will play a part in its deliberations about the appropriate level for its inflation target. The bank's five-year agreement with the federal government on its inflation target is up for renewal before the end of 2016, and one of the things the bank has been debating is whether it should consider raising the inflation target - something that would effectively build in some extra room before rates approach zero, something that has become a problem for many central banks. But the option to go into the negative with policy rates would imply that there's already more room to cut rates than bankers had believed.

"This discussion today informs that [inflation target] discussion. If interest rates can go below zero, you get a bit of room to maneuver on the other side."