Cross-border integration making it trickier to control inflation, Poloz says

By Barrie McKenna
September 27, 2016 – *The Globe and Mail*

Growing global economic integration is making it trickier for central banks to control inflation within their own borders, Bank of Canada Governor Stephen Poloz says.

Companies, such as auto makers and smart phone makers, have developed vast global network of suppliers that tie them into price changes in other parts of the world, Mr. Poloz explained Monday in a lecture at Western Washington University in Bellingham, Wash.

"It is not surprising that globalization has made domestic inflation more sensitive to global demand developments and less sensitive to global disturbances," Mr. Poloz said in prepared remarks.

Higher trade integration may also trigger greater fluctuations in interest rates and currencies, he added.

Central banks that don't take "rising trade integration into account" may struggle to tame inflation and may react too slowly to economic shockwaves coming from other parts of the world, he said.

"Policy-makers need to acknowledge that international developments will have an influence on their economies and on the volatility of their financial markets," he warned.

The main tool that the Bank of Canada uses to keep inflation near its two per cent target is the so-called overnight rate, a benchmark for the interest rate that commercial banks charge each other on short-term loans.

Mr. Poloz pointed out that foreign subsidiaries of Canadian companies generated sales of $510-billion in 2013, or nearly as much as their corporate parents exported to the rest of the world from Canada ($573-billion).

Roughly half of foreign sales by Canadian companies were in the U.S., where Canadian companies now employ 600,000 people.

"There is almost as large a Canadian economy operating in foreign countries as there is in the domestic export sector," Mr. Poloz said.

Mr. Poloz cited the example of manufacturing, where 50 per cent of Canadian exports go to affiliated companies in the U.S. Likewise, 40 per cent of factory exports to Canada are within companies.

The evidence points to "a very high level of cross-border integration, at least in certain manufacturing sectors, including automobiles, aerospace and telecommunications," he said.

In the auto sector, the final assembly of a vehicle may account for as little as a tenth of the car's final value because so many of the parts are made by other suppliers, according to Mr. Poloz.

Mr. Poloz was delivering a memorial lecture in honour of Paul Storer, an economics professor, who died last year. Prof. Storer's work focused on trade integration, particularly between Canada and the U.S. He and Mr. Poloz worked together at the Bank of Canada in the mid-1980s.