



B A C K G R O U N D E R S

# The Benefits of Low Inflation

Consistent with its mandate, the Bank of Canada conducts monetary policy so as to promote the economic and financial welfare of Canadians. It pursues this objective by keeping [inflation](#) low, stable, and predictable, thus providing a climate that is more favourable to sound, sustained economic growth and job creation.

## High inflation has many costs

- When inflation is high, people increasingly fear that this will erode their future purchasing power and their standard of living.
- Uncertainty about where prices of goods and services will be in the future makes it more difficult for people to make sound economic decisions. That uncertainty is magnified when prices are rising, since in these circumstances inflation is seldom stable and predictable.
- High inflation encourages speculative investments at the expense of more productive investments. It can also create the illusion of temporary financial well-being while masking fundamental economic problems.
- When inflation is high, businesses and households spend more time and money trying to protect themselves from the effects of rising costs and prices. Business people, workers, and investors respond to rising inflation by pushing up prices, wages, and [interest rates](#) to protect themselves. This can lead to a “vicious circle” of rising inflation.

- Inflation can mean particular hardship for those individuals whose incomes don’t keep pace with rising prices, especially people on fixed incomes such as pensioners.

## Low inflation has many benefits

- When inflation is low, consumers and businesses are better able to make long-range plans because they know that the purchasing power of their money will hold and will not be steadily eroded year after year.
- Low inflation also means lower nominal and real (inflation-adjusted) interest rates. Lower real interest rates reduce the cost of borrowing. This encourages households to buy durable goods, such as houses and autos. It also encourages businesses to invest in order to improve productivity so that they can stay competitive and prosper without steadily having to raise prices.
- Sustained low inflation is self-reinforcing. If businesses and individuals are confident that inflation is under long-term control, they do not react as quickly to short-term price pressures by seeking to raise prices and wages. This helps to keep inflation low.

For more details, see “[On Target](#)” and “The Benefits of Price Stability,” May 1995, [Monetary Policy Report](#) (Appendix).

May 2013

