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Opening Statement by Stephen S. Poloz
Governor of the Bank of Canada
Press conference following the release of the
Monetary Policy Report
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Good morning. Senior Deputy Governor Wilkins and I are pleased to be here to answer your questions about today's interest rate announcement and our *Monetary Policy Report* (MPR). Before taking your questions, let me offer some insight into Governing Council's deliberations.

Our discussion began with the big picture: inflation is on target and the economy is operating close to capacity. Our outlook published today is that this situation will continue. Governing Council believes that higher interest rates will be needed to keep inflation on target, and that is consistent with our actions today.

Monetary policy is, of course, always conditioned on new data, particularly when they do not align with the Bank's projections. A few data points over the past few weeks have seemed out of step with those projections, but when all the data are taken together, the economy seems to be on track.

Given the various uncertainties we face, the Bank is particularly data dependent at this time. However, that does not mean that monetary policy will react to every data fluctuation. A better way to think of this is that it takes hundreds of data points to make a complete picture, and each new one helps the picture come into sharper focus. So, when a data point comes in differently than what the Bank or other forecasters expect, it matters to the big picture, but it is almost never decisive on its own.

As we have previously discussed, an important issue we face is to understand how the economy reacts to higher interest rates, given the high debt loads being carried by Canadian households. We are monitoring this situation closely. We have seen a moderation in credit growth and the debt-to-income ratio has begun to edge lower. At the same time, the housing market is also dealing with the revised B-20 Guideline for mortgage lending, and the data do not yet permit a sharp distinction between the impact of the guideline and the effects of higher interest rates.

Governing Council did take some comfort from an analysis of the renewal process for five-year mortgages taken out in 2014 and 2015 and up for renewal in 2019 and 2020. This analysis shows a very modest increase in debt-service ratios compared with the date of origination. Keep in mind that many households have had some income growth during these past five years, and these households may have grown accustomed to higher income levels. They may face an adjustment as their debt-service ratio rises once again, with consequences for their consumption spending. Of course, this issue is most important for highly indebted households. We also know that the jump in payments will be greatest for those who took out mortgages when interest rates were at their lowest levels, in 2015 and 2016, so the mortgage renewal process is likely to weigh on the economy more in 2020 and 2021. All that being said, Governing Council concluded that the economy should be resilient to higher interest rates, provided that labour income continues to grow.

The biggest issue on the table was trade tensions. As discussed before, uncertainty around the future of the North American Free Trade Agreement has caused some companies to delay investment spending or to move their investments to the United States. This channel was identified and captured in our projection some time ago. The recent imposition by the US government of actual tariffs on Canadian exports has made the situation more concrete. In the projections we are presenting today, we have added more negative judgment to our business investment forecast in recognition of this. We have also incorporated the effects of the US tariffs on steel and aluminum, and the various countermeasures implemented around the world. Box 2 in the MPR gives a flavour of the complex effects such actions will have on the economy. Let me summarize briefly.

A US company importing Canadian steel must now pay a 25 per cent tariff. They may instead buy steel made in the United States or in some other country. Or, if no obvious substitutes are available, they may just pay the higher price. Or, the Canadian company may offer to reduce its price in order to absorb some of the tariff's impact. Or, it may look to other markets to sell its products. The response of companies will depend on how long they think the tariffs might be in place—for example, it appears that if NAFTA is successfully renegotiated, those tariffs would no longer be in effect. The point is, the outcome depends on individual reactions, which depend on the circumstances.

And then there are countermeasures. Canada has imposed a 25 per cent tariff on steel imported from the United States. This would seem to level the playing field, but many of the same complexities enter the analysis. All things considered, our analysis suggests that Canadian exports would fall, as would Canadian imports. Prices would rise at a time when the economy is already operating at capacity, so inflation would rise at least temporarily, but the effect could persist. Consumers would have less purchasing power, so demand would slow. Meanwhile, the potential of the economy would be eroded as companies invest less and become less competitive. So, the economy would see shocks to both demand and supply, resulting in two-sided risks to future inflation. Furthermore, the net effect on the economy might be buffered by any fiscal actions that governments might take.

Now, as we said in the MPR, these various effects are likely to be small for the measures already taken. In contrast, a large tariff on Canadian-made automobiles and parts would have a much greater effect on trade and the economy through these same channels. People are understandably concerned about this sort of escalation and want to know how monetary policy might react to it. Indeed, there was speculation that the Bank would not move interest rates today because of the possibility of further trade measures.

The Bank cannot make policy on the basis of hypothetical scenarios. We felt it appropriate to set aside this risk and make policy on the basis of what has been announced. Given the multiple channels through which protectionist measures affect economies, it should be clear that monetary policy is ill-suited to counteract all of their effects. It may, of course, play a supporting role, in conjunction with other policies. But, to put it bluntly, the economy would slow, inflation would rise, and the exchange rate would depreciate, adding further to near-term price pressures in the Canadian economy. Therefore, the implications for interest rates of an escalation in trade actions would depend on the circumstances. Let me emphasize that monetary policy by itself could not undo the long-term damage to jobs and income that could result from rising protectionism.

All this being said, it is important to remember that our economy is in a good place. We are operating near capacity, companies are investing even if some are hesitating, the labour market has been strong, and, most importantly, inflation is on target. In this context, higher interest rates will be warranted to keep inflation near target. Governing Council will continue to take a gradual approach to adjusting rates, guided by incoming data.

With that, Senior Deputy Governor Wilkins and I would be happy to answer your questions.