Tiff Macklem: Delivering price stability - learning from the past, preparing for the future

Remarks by Mr Tiff Macklem, Governor of the Bank of Canada, at the Greater Vancouver Board of Trade, Vancouver, British Columbia, 16 December 2024.

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Introduction

Good afternoon. It's a great pleasure to be back in Vancouver for my final speech of 2024. I want to thank the Greater Vancouver Board of Trade for inviting me. I'm particularly looking forward to our discussion after my remarks. Hearing from you is always the best part.

As some of you will recall, I was here in Vancouver two years ago in December 2022. Inflation was close to 7%. We'd just raised the policy rate by 50 basis points to 4¼%, our seventh straight rate hike in our fight against inflation, and we signalled we would be considering increasing rates further. Indeed, we ended up raising our policy rate three more times to 5%.

Today, inflation is back at our 2% target. Last week we cut our policy rate by 50 basis points to 3¼%, the fifth consecutive decrease since June.

We've come a long way in the past two years. Monetary policy has worked to restore low inflation. Interest rates have come down substantially, and household spending has begun to pick up.

But I am not here to give a victory speech.

Price stability is low, stable inflation. Inflation is low once again; now we need to stabilize it around the 2% target. That's price stability. That's giving Canadians the confidence that their cost of living will not change materially year to year.

Today I want to talk about delivering price stability for Canadians.

I'll start with the present-where the economy is today-and what we are focused on to keep inflation close to the 2% target.

Then I will look back to learn from the past. We need to use the pandemic experience to prepare for future crises.

Finally, I'll look ahead. The future looks more uncertain, and more prone to shocks than we would all like. We need to be prepared. And that work is underway.

Monetary policy today

Let's start by looking at current economic conditions.

The economy grew by 1% in the third quarter, which was slower than we expected. Recent data offer a mixed picture. Consumer spending and housing activity both picked up in the third quarter, as lower interest rates started to boost household spending. Annual revisions also suggest the level of gross domestic product (GDP) is more than 1% higher than previously reported. However, weakness in business investment, inventories and exports point to less momentum headed into the fourth quarter, and the labour market is still softening.

Looking ahead, a number of government measures will affect the dynamics of growth and inflation. Lower immigration targets suggest GDP growth next year will be lower than we forecast in October. Other federal and provincial government policies-including the GST break on some items, one-time payments to individuals, and changes to mortgage rules-will also affect household spending and inflation in the months ahead. As always, we will look through the effects that are temporary and focus on underlying trends to guide our policy decisions.

Inflation has been close to target since the summer. It was exactly 2% in October and is expected to average close to the 2% target over the next couple of years. In the October CPI data, the upward pressure on inflation from shelter and the downward pressure from goods prices have both moderated as expected. In the next few months, the GST holiday will temporarily lower inflation but that will be unwound once the break ends.

There are risks around our inflation outlook. Elevated wage increases combined with weak productivity could boost inflation as businesses look to pass on higher costs. Or the economy could continue to grow below its potential which would pull inflation down. With inflation back to 2%, we are equally concerned with inflation coming in higher or lower than expected.

The economic outlook is also clouded by a major new uncertainty-the possibility the incoming US administration will impose new tariffs on Canadian exports. No one knows how this will play out in the months ahead.

With inflation back to target, the economy in excess supply and the growth outlook softening, we cut the policy rate by 50 basis points at each of the last two decisions. Monetary policy no longer needs to be clearly in restrictive territory. We want to see growth and hiring pick up to absorb the unused capacity in the economy and keep inflation close to 2%.

Learning from the past

So that's the present. As we deal with the present, we also need to reflect on the past. And as much as we would all like to forget the dark days of the pandemic, we need to learn from this unprecedented crisis.

To that end, the Bank of Canada has been conducting a review of the policy actions we took to restore financial stability and support the economy during the pandemic. This work is nearly done, and once it is completed, we will publish our review together with an assessment by an independent panel of experts. But some of the key takeaways are already clear.

Our pandemic response was effective in restoring market functioning, preventing an even worse economic calamity, and supporting the recovery. The crisis was developing rapidly, and a quick and bold response was critical. But we can see in retrospect that when we use extraordinary tools, we need to be clear about what we're trying to achieve with those tools and under what conditions they'll no longer be needed. Perhaps most importantly, we need to remember that the actions we took were truly extraordinary. The bar to use exceptional tools has always been high in Canada-and it should remain high. These are not conventional monetary policy.

We also need to take on board the lessons from the surge in inflation that followed. Why did inflation rise so rapidly? And how effectively did monetary policy respond? To be prepared for the future, we need to be clear-eyed about what surprised us. My colleagues and I have already written and spoken about some of the lessons, so I can be brief here.[1] But I'll highlight three.

First, economic supply matters every bit as much as demand, and we need to understand it better. Monetary policy typically focuses mostly on demand. That's because interest rates largely affect demand and because supply usually evolves more smoothly and predictably. The pandemic reminded us we cannot take that for granted. Supply disruptions can be sudden, severe and persistent, they can accumulate, and they are more inflationary when demand is strong. We also learned that what matters for inflation is not only the demand-supply balance for the economy as a whole but also across different sectors. The disinflation in weak sectors may be smaller than the inflationary impact of sectors that are overheated. In the future, we need better information and analysis about the supply side of the economy.

Second, we learned that price-setting behaviour changes when inflation is high. Typically, businesses are hesitant to raise prices. They worry their price increases will stand out and they'll lose customers to their competitors. But as the economy came out of the pandemic, supply disruptions and higher commodity prices pushed up costs. And demand was very strong. Businesses had trouble keeping up with orders. With high demand, businesses felt they could pass on more of their cost increases than usual, and more rapidly. What we learned is that, in some contexts, businesses can dramatically change their pricing behaviour.[2] Our economic models and forecasts need to reflect this reality.

And finally, we learned-or perhaps relearned-just how much people hate inflation. All of a sudden, people couldn't afford the things they need to live. And while inflation is low once again, many prices are still a lot higher than they were before the pandemic. So people feel ripped off. And that erodes public trust in our economic system.

The spike in inflation in 2022 was a reminder that even though inflation was relatively low and stable for 30 years leading up to the pandemic, central banks cannot take public trust for granted. We need to earn that trust, by being clear about our objectives, accountable for our actions, and humble in the face of uncertainty.

Preparing for the future

That brings us to the future. Unfortunately, it looks more uncertain than it did before the pandemic.

Big structural changes are already underway. Deglobalization, demographic shifts, digitalization and decarbonization are all having significant effects on jobs, growth and inflation. Trade protectionism and economic fragmentation are rising, and the appetite for global cooperation is waning. Shifting international relationships are adding uncertainty and costs and altering investment plans. Aging populations and changes in immigration policies will also affect the supply and cost of labour. New technologies, including artificial intelligence (AI), will disrupt existing industries and create new ones. And the impacts of climate change and the transition to low-carbon economies are becoming more pervasive.

Monetary policy cannot eliminate any of this uncertainty. But by keeping inflation low and stable, monetary policy can avoid making it worse. So how do we prepare?

For 2025, we have set three priorities to help us deliver for Canadians in a more uncertain world. We need to work with our international partners to try and shape the future. Canada's G7 presidency next year is an opportunity to lead. We also need to improve our analysis, using richer information and better tools to respond to inevitable shocks. And finally, we need to ensure our monetary policy framework is fit for purpose.

Let me take each of these in turn.

Work with our international partners

We often focus on negative international spillovers-the harm one country's actions can have on other countries. But we can create positive spillovers when we work together. The shared resolve of major central banks to fight post-pandemic inflation reduced the demand for global goods and took pressure off tangled supply chains. That helped us all get inflation back down without causing major recessions.

In 2025, Canada hosts the G7 meetings. That gives us a chance to build on these positive spillovers. International cooperation is getting harder, but as shared global risks accumulate, it is more important than ever.

At the top of the risk list is economic security. The combination of higher sovereign debt, higher long-term interest rates and lower economic growth is making the world more vulnerable. War, geopolitical tensions and the rising threat of protectionism are compounding these vulnerabilities. The democracies of the G7 will be stronger if we confront our shared economic security issues together.

We must also confront other mutually important issues, including the risk and opportunity of AI, the potential vulnerabilities arising from non-bank financial institutions, and the need to improve cross-border payment systems. We can't do these things alone.

Richer information and better tools

Here at home, the volatility of the past several years highlights the need to sharpen our policy tools.

That starts with richer information. We have invested in detailed sectoral data on global value chains. We have expanded our surveys to reach many more businesses and consumers in Canada. And we are using large micro-level datasets on prices, jobs and household credit to enrich our analysis.

With richer information, we can build richer economic models. We've begun work on our next generation of economic models that incorporate the key lessons of recent years.

This includes models that better capture the role of supply chains in production and the connectivity between sectors. This will help us understand and track how supply disruptions flow through our economy, and how they affect specific sectors and overall inflation.

The new models will also distinguish between inflation that comes from higher demand and inflation that comes from higher input costs. And the new models will allow us to gauge the impact of changes in price-setting behaviour. This should all help us better understand inflation dynamics and develop monetary policy playbooks to better respond to shocks.

Finally, our new models will also help us manage uncertainty using alternative scenarios. We'll be able to build scenarios with different assumptions about key inputs to the Canadian outlook, like the price of oil or the strength of the US economy. We'll also be able to examine scenarios with different views about how the economy works. Looking at the economy through different lenses and regularly challenging our assumptions are the best ways to manage the risk and uncertainty that surrounds the economic outlook.

Review of monetary policy framework

The final-and critically important-priority for the Bank is the review of our monetary policy framework. Every five years, the Government of Canada and the Bank of Canada review our flexible inflation-targeting framework to ensure it is the best way for us to promote the economic and financial well-being of Canadians. The joint nature of the agreement between the government and the Bank reinforces both the democratic legitimacy of the framework and our operational independence to pursue the agreed-upon objectives.

Right now, we're considering what issues to focus on in the upcoming review, reflecting on the big forces on the economy and what we're hearing from Canadians. This points to several questions. In a more volatile world, how do we identify and measure underlying inflation? Is 2% still the best target for the future? What's the interaction between housing affordability and monetary policy? I'll have more to say about the framework review in the new year, once the work truly begins.

More than ever, Canadians are aware of economic issues and of the work we do at the Bank. And they are reaching out to share their views. We welcome this, and we will continue to seek out diverse perspectives as we undertake our framework review.

We want the best monetary policy framework for the future-to fight the next battle, not the last one.

Conclusion

Let me conclude.

As we look ahead, the world looks more shock-prone. We hope some of the major uncertainties hanging over the world will be resolved. We can't count on that-but we can prepare.

With inflation back to 2%, we are in a better position to respond to whatever may come. We want to keep inflation close to the target-that's delivering price stability for Canadians.

We have reduced the policy rate substantially since June, and those cuts are working their way through the economy. Going forward, we will be evaluating the need for further reductions in the policy rate one decision at a time. In other words, we anticipate a more gradual approach to monetary policy if the economy evolves broadly as expected. Our decisions will be guided by incoming information and our assessment of the implications for the inflation outlook.

Even as we manage the present, we are preparing for the future. That means working with our international partners. It means making sure monetary policy is a source of stability, not further uncertainty. And it means taking on board the lessons from the pandemic and its aftermath: tapping new data sources and building our capacity to better manage uncertainty. Over the next year and half, we will also be reviewing our monetary policy framework.

We are committed to being transparent and accountable in everything we do. That starts with listening. We're visiting more communities across the country. We are also doing more to explain our decisions. I now hold a press conference after every decision to answer the media's questions, and this is followed by a written summary of our monetary policy deliberations. The Bank has added an external Deputy Governor to provide a fresh perspective, and we are currently recruiting for a second one. We are also finding new ways to reach Canadians through new communication products and platforms. We will continue to look for ways to be more transparent and accountable.

We want to earn the public's trust. And we are. Increasingly, households and businesses expect inflation will be low. And as that confidence in low inflation has come back, so has trust in the Bank of Canada. Our surveys show Canadians better understand our role and they see us as working to serve their best interests. That's encouraging. We are intent on rewarding that trust, by delivering low and stable inflation, by learning the lessons of the past, and by being the central bank that Canadians can rely on, now and in the future.

Thank you.

I would like to thank Don Coletti, Oleksiy Kryvtsov, Marie-France Paquet, Jonathan Witmer and Jing Yang for their help in preparing this speech.

[1] See T. Macklem, "The path to price stability" (speech delivered to the Canadian Club Toronto, Toronto, Ontario, December 15, 2023); T. Macklem, "Putting the resolute in resolutions: Looking ahead to lower inflation" (speech delivered to the Business Council of British Columbia, Vancouver, British Columbia, December 12, 2022); R. Mendes, "Keeping inflation at 2%" (speech delivered to the Greater Charlottetown Area Chamber of Commerce, Charlottetown, Prince Edward Island, November 26, 2024); and T. Macklem, "The Bank of Canada's response to post-COVID inflation, and some lessons learned," in B. English, K. Forbes and A. Ubide (eds), *Monetary Policy Responses to the Post-Pandemic Inflation*, Centre for Economic Policy Research Press (February 2024).

[2] See N. Vincent, "Understanding the unusual: How firms set prices during periods of high inflation" (speech delivered to the Chamber of Commerce of Metropolitan Montreal, Montréal, Quebec, October 3, 2023).