Tiff Macklem: Structural change, supply shocks and hard choices

Remarks (virtually) by Mr Tiff Macklem, Governor of the Bank of Canada, at the Chapultepec Conference, Mexico City, 6 February 2025.

* * *

Good afternoon. I'm pleased to be able to join you virtually to talk about the challenges that lie ahead for central banks. There's a lot to discuss.

But my first order of business is to congratulate and thank Agustín Carstens for his leadership as General Manager of the Bank for International Settlements (BIS). Your term, Agustín, has been marked by significant global upheaval-from pandemic shutdowns to war in Europe and double-digit inflation. These past few years have not been easy.

Through it all, you have been a source of unwavering wisdom. Your clear thinking in the face of the unknown, your long view and your deep understanding of our global interdependence-all combined with the experience and pragmatism of a former minister of finance and then central bank governor-have made you an invaluable leader.

More than that, through the BIS, you've brought us together with your friendship and your ability to get directly to the heart of the issue. You've helped us learn from each other. And you've made us better together.

I know there will be an opportunity to celebrate you in Basel as your retirement in June approaches. But I wanted to recognize your exceptional leadership in your home country. For those of us in the Americas, your special interest in our region has been deeply appreciated. Whatever you do next, I know Mexico and the Americas will be an important part. Thank you, my friend.

Now, let me turn to the challenges ahead. We are facing a global economic landscape that has shifted in recent years, and this shift has important implications for central banks.

As Agustín has highlighted in a series of insightful speeches, the structural tailwinds of peace, globalization and demographics are turning into headwinds-and the world looks increasingly shock-prone.

Higher long-term interest rates, elevated sovereign debt, slower economic growth and lagging productivity make all of our economies more vulnerable. Compounding these vulnerabilities are war, rising trade protectionism and economic fragmentation. In addition, new technologies-including artificial intelligence-are set to disrupt existing industries and create new ones. And we are seeing more frequent catastrophic weather events as the impacts of climate change become more pervasive.

As 2025 begins, we are facing new uncertainty with a shift in policy direction in the United States. President Donald Trump's threats of new tariffs are already affecting business and household confidence, particularly in Canada and Mexico. The longer this uncertainty persists, the more it will weigh on economic activity in our countries.

If significant broad-based tariffs are indeed imposed, they will test the resilience of our economies in the short run and reduce long-run prosperity. Tariffs mean economies work less efficiently. There will be less investment and lower productivity. That means our countries will produce less and earn less. Monetary policy can't change that.

What monetary policy can do is help with the short-run adjustment. But even here, monetary policy has to strike a balance. Significant, broad-based tariffs will sharply reduce demand for our exports. At the same time, a weaker exchange rate, retaliatory tariffs and supply chain disruptions will raise import prices, putting upward pressure on inflation.

With a single instrument-our policy interest rate-central banks can't lean against weaker output and higher inflation at the same time. So we will need to carefully assess the downward pressure on inflation from weaker economic activity, and weigh that against the upward pressures from higher input prices and supply chain disruptions.

Other structural headwinds pose similar challenges for monetary policy. They'll impact both demand and supply, slowing growth while adding cost. Monetary policy cannot address these headwinds directly or offset their economic consequences.

In a world with more structural change and more negative supply shocks, central banks will be faced with harder choices. And harder choices bring risks of public disappointment and frustration. We will face criticism about our decisions-and about how well monetary policy is seen to have worked when confronted with forces that are mostly out of our hands. We will be called ineffective or criticized for not doing enough. And some will challenge our independence.

So, what can all of us do?

First, we can be humble about what we don't know, but also confident in the effectiveness of our frameworks. We didn't get everything right through the pandemic. And elevated inflation and higher interest rates have been difficult for our citizens. But in Canada, as in many other countries, inflation has come down. And we restored low inflation without causing a recession or major job losses.

Guided by our frameworks, we can maintain confidence in price stability.

Second, we can be just as clear about what monetary policy cannot do. There will always be forces beyond our influence, and while we need to understand those forces, we should also be clear that understanding is not the same as controlling. And we need to avoid the temptation to overload monetary policy by expecting more of it than it can deliver.

Third, we can recognize that the world has changed. Structural headwinds and supply shocks require different types of information and analysis. This means investing in richer information about the supply side of the economy and building models that can analyze sectoral shocks and their transmission. It means reaching out and listening to households and businesses. It means looking at our economies through different lenses, regularly challenging our assumptions, and using scenarios to help manage uncertainty.

Fourth, let's acknowledge that working together has never been easy and it's getting harder. But let's also remember that it's important. We are more effective if we confront our shared challenges together. The shared resolve of central banks to fight the post-pandemic surge in inflation helped all of us bring inflation down. This was a positive international spillover and, together, we can generate other positive international spillovers.

Finally, we need to remain evidence-based, technocratic and professional, and free of political influence. We need to be open, accountable and transparent. And we need to be learning institutions-when faced with valid criticism, we should critically evaluate our policy actions and be willing to improve. Being independent and accountable and continuously learning is how we build trust.

The world is a tougher place today than it was a few short years ago. And facing the headwinds before us will not be easy. But that's why we have independent central banks-we are designed for tough times.

I look forward to hearing from my esteemed colleagues on this panel.