MONEY, INFLATION, AND THE BANK OF CANADA (A SPECIAL STUDY OF THE C.D. HOWE RESEARCH INSTITUTE) pdf

1: David Laidler - Wikipedia

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In times such as these, it is common for people to focus on day-by-day or even hour-by-hour events, and to lose sight of the future. But tonight, I want to focus on the future; specifically, the future of inflation targeting in Canada. I will finish with some remarks on recent developments in the Canadian economy and in financial markets. Inflation Targeting â€” Room for Improvement? It may seem as if the Bank of Canada has been talking about inflation targeting forever. But as an approach to monetary policy, inflation targeting is not all that old - less than 20 years. In the words of economics professor Ken Kuttner, inflation targeting is still in its adolescence. But let me be clear: Whatever issues there may be, our policy framework of inflation targeting, supported by a floating exchange rate, remains the most effective approach yet devised for conducting â€" and explaining â€" monetary policy in a country like Canada. No central bank that has adopted inflation targeting has later abandoned it. Consumers and businesses have been able to manage their finances with greater certainty about the future purchasing power of their savings and income. Economic signals sent by movements in relative prices have been clearer, and labour markets have been able to function better. Low and stable inflation has also meant that interest rates, both in nominal and real terms, have been lower. Inflation targeting has also been quite successful in anchoring inflation expectations and in dampening economic fluctuations, owing largely to the transparency of communications that the framework encourages. Well-anchored inflation expectations have helped to reduce the propagation of price shocks to wages and prices and to dampen the sensitivity of inflation to excess demand and supply. This has made the conduct of monetary policy more effective and efficient. A better monetary policy framework has led to better inflation outcomes, increased policy credibility, and a more stable macroeconomic environment. Reflecting the success of the inflation-targeting regime, the government and the Bank of Canada renewed the inflation-target agreement in November of last year for another five-year period. As part of that renewal, we took the opportunity to refine and clarify our framework, and we reached conclusions in three areas: We concluded that we should continue to look at measures of core inflation as a way to gauge the strength of underlying inflation, although our target remains total CPI inflation. As for asset price movements, we will continue to take them into account to the extent that they have implications for future inflation. And we will continue, generally, to aim to return inflation to the 2 per cent target over a six- to eight-quarter horizon, unless faced with shocks where a slightly shorter or slightly longer horizon would be more appropriate. Should such a case occur, we would communicate it transparently. While inflation control is clearly the right assignment for monetary policy, there always remains the question of whether the specific regime established in the s will deliver the greatest contribution to economic performance in the decades ahead. So, when the inflation-targeting agreement was renewed last year, the Bank published a background document that spelled out two basic questions, which we hope to answer: Is 2 per cent the right target? And should the Bank express its target in terms of a path for the level of prices, instead of the rate of inflation? Is 2 Per Cent the Right Target? When the Bank and the Government of Canada first agreed on a series of targets for inflation in , a 2 per cent rate of inflation was seen by the Bank as a step towards price stability, which had yet to be defined. But it was also seen by most as a very ambitious target. After all, it had been decades since the Canadian economy had experienced a sustained period with inflation at 2 per cent or less. Indeed, during the s, we had had trouble containing inflation to 4 per cent. In addition, there were fears at the time that the introduction of the Goods and Services Tax could rekindle inflationary pressures. But inflation quickly fell into line following the announcement of the targets, and has averaged very close to 2 per cent since the end of Since then, we have seen that the economy functions better at a low rate of inflation. But this experience raises the question: Would a lower inflation rate lead to further efficiency gains for the Canadian economy? There are a number of reasons to think so. Lower inflation would reduce the misallocation of resources by reducing price dispersions and making price signals clearer. It would also reduce the costs of updating prices and the economic distortions coming from a non-indexed tax system. We have been researching this issue for some time. In a recent commentary, David Laidler of the C. Howe Institute expresses lingering pessimism about finding material efficiency gains. He focuses instead on the distributional benefits of lower inflation, arguing that these will take on increased importance as our population ages and a growing number of Canadians rely on fixed incomes. These have been explored in two recent papers by Bank staff: But while there may be benefits to be gained from a lower inflation target, there may also be costs involved in getting there. Adjusting those expectations down to a lower level, say 1 per cent, may not be easy, although the cost of lowering inflation expectations can be expected to be lower than when inflation targeting was first adopted, given the credibility that the Bank â€" and our inflation-targeting framework â€" have acquired. However, the lengthening of non-indexed wage and debt contracts would raise some transition costs. Two main arguments have traditionally been advanced against the idea of targeting a lower inflation rate. The first is the concern about downward wage rigidity: That it is more difficult to adjust real wages downwards in an environment of very low inflation because this will likely involve cuts to nominal wages. The second argument is that central banks could have problems implementing a stimulative policy in a very-low-inflation environment because nominal interest rates cannot go below zero. With respect to downward wage rigidities, research described at the time of the renewal of the target, 7 as well as labour market developments generally, do not appear to provide a compelling argument against a lower inflation target. But the zero-bound constraint on interest rates remains a critical issue. The adoption of price-level targeting, however, could help central banks deal with the zero-bound constraint. So let me now turn to the topic of price-level targeting. A Target for the Price-Level Path? The essential difference between a target for the price level which could rise over time and an inflation target is that under pure inflation targeting, past deviations from the target do not have an impact on the future targeted rate of inflation. Movements in the price level that are perceived to be "one-off" events are ignored. But with price-level targeting, past inflation performance does matter. If inflation had been below trend, causing the price level to fall below target, monetary policy would need to generate above-trend inflation for a while in order to return the price level to the target over time. Symmetrically, if inflation had been above trend, lifting the price level above its target, the central bank would need to bring about temporarily below-trend inflation to return the price level to its target path over time. Economic theory suggests that targeting a path for the price level would benefit the economy by adding certainty about prices over the long term. This should support economic efficiency by reducing the risks associated with long-term financial contracts. Providing added certainty about future prices would be of particular benefit to people living on fixed incomes. And as I mentioned earlier, price-level targeting might also help central banks avoid some of the difficulties associated with the "zero-bound" issue. If people anticipate that the central bank would take the appropriate measures to achieve the target, expectations about the future price level could become very well anchored. In these circumstances, it would take smaller moves in nominal interest rates to bring about the needed change in aggregate demand, and hence the zero bound is less likely to become a problem. If a shock were to bring the price level below the target, the anticipation that prices would return to target over time would lower real interest rates and help boost demand, thus requiring a smaller reduction in nominal interest rates. Put another way, the drop in prices below target would induce buyers to take advantage of the temporarily low prices. This would alleviate the problems posed by the zero bound. There is, however, concern about how a central bank would need to respond to certain shocks under price-level targeting. Under inflation targeting as it is now practised, one-off relative price movements or changes in indirect taxes would not trigger a monetary response as long as inflation expectations remain anchored. By focusing on the future trend of inflation, an inflation-targeting central bank accommodates one-off shifts in the price level and need not disturb the balance between aggregate demand and supply. But under price-level targeting, persistent relative price shocks would require a monetary policy response designed to bring about offsetting changes in other components of the consumer price index, which may involve shifts in the balance between aggregate demand and supply. It may be possible for a central bank to target the level of a core price index, which is less subject to relative price movements, rather than the total index. But this could add significantly to the communications challenges posed by price-level targeting. These communications challenges are likely to be greater for a central bank that practises price-level targeting than for one that practises inflation targeting. The general public can easily relate to a well-publicized and straightforward number like the inflation rate, and to an inflation target that remains constant over time. Yet, a solid public understanding is important if the full benefits of increased certainty about the future price level are to be realized. Any debate about the pros and cons of price-level targeting is bound to be based on theory, because only one country has had any real experience with it: Sweden in the s. That said, we now have the ability to construct the kinds of complex economic models â€" multi-goods models with relative price movements â€" that are important for conducting research into price-level targeting. And so the Bank has begun a concerted and ambitious research program for the next three years. But we know that this task is too large for us to accomplish ourselves. We very much want to get others involved in this research agenda, so that we can benefit from their knowledge and expertise. The Bank has held special sessions connected with meetings of various economic groups, and we will be hosting joint conferences with other central banks, as well as our own research conference. The Bank has also launched a new website: This site is intended to be a hub where interested researchers can find out what research has been done, and what is being planned. At the Bank of Canada, we want to be confident that we have developed the best policy framework to deliver on our mandate of promoting the economic and financial welfare of Canadians. Inflation targeting has proven its worth in helping Canada achieve solid economic performance. But it is still relatively young, and there is some room for it to grow. Over the next few years, we hope to answer some of the lingering questions we have had about inflation targeting. We are not yet at the end of monetary history. And we hope that many others, including some of you here tonight, will join us in that effort. Recent Economic and Financial Developments Let me now turn to recent developments. Over the past few weeks, there has been significant turmoil in financial markets around the world, and risk aversion has increased substantially. At the heart of the matter has been a reassessment of risk in credit markets triggered by concern about exposures to U. It has been extremely difficult to re-establish market prices for certain assets, particularly highly-structured asset-backed instruments.

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Get this from a library! Money, inflation, and the Bank of Canada: an analysis of Canadian monetary policy from to early [Thomas J Courchene; C.D. Howe Research Institute.].

Comments Government statisticians who have the important task of closely monitoring inflation face a growing outcry in country after country for seeming to underestimate consumer price increases and their impact on household incomes and spending - either through deliberate policy Hello Argentina , inaccuracy or a lack of effective tools. So it is more than a little surprising to find a new study from the respected C. Howe Institute criticizing Statistics Canada for consistently overestimating consumer price inflation. Instead, Statscan relies on past behaviour and makes changes only occasionally, the study says. Weightings within the basket are changed every four years. Story continues below advertisement These flaws are far from inconsequential, the study argues. They affect everything from crucial monetary and fiscal decisions to income tax collections and pension or other spending tied in some way to the CPI. The report pegs the cost to Ottawa at hundreds of millions of dollars annually. The agency acknowledges that the weightings need to be adjusted more frequently to better capture consumer patterns. It is currently working with basket weightings, and will switch to weights in June. The agency also intends to speed up the changeover process. If we could do it in a year, that would be an improvement. Howe study singles out a particular flaw in the data gathering: So the official inflation estimate accords too much weight to products whose prices are rising. This makes the rate of increase higher than what is actually experienced by the average consumer in the marketplace. These include new products that have not yet been introduced into the CPI; substantial changes in product quality or features; and the effect of new outlets in the marketplace that are not yet adequately represented in the index calculations. If, as is typical, major new entrants have lower pricing than established ones, the index might fail to capture some of that change. Story continues below advertisement Story continues below advertisement Economists agree "that there is upward bias coming from those sources. The challenge is putting a number on it," he said. Different academics using different assumptions have come up with different measurements. Consumers also use the CPI to assess their financial needs and spending capacity. Now, most consumers would argue forcefully that their costs are heading in one direction - up. The stuff we pay for much less frequently - clothes, say, or electronics, autos, furniture and apartment rents - are likely to be much less volatile, declining in price or rising much more gradually. An investigation of U. At the time, the U. Department of Labor was updating its basket of goods only once every 10 years. It subsequently began making adjustments every two years, after the government poured resources into the department. The solution to the Canadian CPI flaws lies in a relatively small increase in funding to enable Statistics Canada to sift through more consumer price data on a more regular basis and in much finer detail, the study says.

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Academic affiliations[edit] In addition to many visiting appointments, David Laidler has held full-time teaching positions at the University of California, Berkeley , the University of Essex , and the University of Manchester , but from onward his primary academic affiliation has been with the University of Western Ontario. Robson , Hellmuth Prize for distinguished research in the Humanities and Social Sciences by a member of the faculty of the University of Western Ontario â€"05, Donner Prize for the best book of the year on Canadian public policy. Joint recipient with William B. Spanish translation , French translation , Italian translation , Spanish translation of 2nd Edition , Japanese translation of 3rd edition , Chinese Translation of 3rd Edition, Shanghai Spanish translation of 1st edition, , Polish translation of 3rd Edition, , Italian translation of 3rd Edition, , Spanish translation of 3rd edition, , Bulgarian translation of 3rd Edition, , Spanish translation of 4th edition, The Golden Age of the Quantity Theory: The Development of Neoclassical Monetary Economics: How Shall We Govern the Governor? Two Nations One Money? Howe Institute with W. The Great Canadian Disinflation: Fabricating the Keynesian Revolution: Howe Institute, with W. Robson Macroeconomics in Retrospect: Rowe "Review of The Shadow of Keynes. Some Evidence from Sweden" with L. Jonung American Economic Review, Dec. A Research Annual A , pp. Humphrey , "Book Review of Robert Leeson, ed. Palgrave Macmillan, ", Economic History Association at eh.

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5: Statscan overestimating inflation rate, study suggests - The Globe and Mail

Statement by the Board of Directors of the Canadian Institute for Economic Policy on interest rates, the exchange rate and inflation = [EnoncÃ© du Conseil d'administraton de L'Institut canadien de politique Ã©conomique sur les taux d'intÃ©ret, les taux de change et l'inflation].

6: The Bank of Canada's Research Agenda and the Future of Inflation Targeting - Bank of Canada

Money, Inflation, and the Bank of Canada (A Special study of the C.D. Howe Research Institute) Dec 01, by Thomas J. Courchene Paperback.

7: Change inflation gauge to better measure home prices: C.D. Howe - The Globe and Mail

The Bank of Canada should pay closer attention to the effects of money and credit growth on inflation and asset markets, according to a study released Wednesday by the C.D. Howe Institute. The study's authors, Dr. David Laidler, fellow-in-residence and member of the C.D. Howe Institute's.

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