C.D. Howe Institute
Institut C.D. Howe

Celebrating/Nous célébrons 50 years/ans

verbatim

October 28, 2010

Canadian Monetary Policy: If It Isn't Broken, Can It Be Fixed?

Remarks to a C.D. Howe Institute Monetary Policy Conference, October 5, 2010

By Don Drummond
Economics Advisor, TD Bank Financial Group
Matthews Fellow and Distinguished Visiting Scholar, Queen's University

I N D E P E N D E N T • R E A S O N E D • R E L E V A N T

Rarely does one receive the gift of being asked to be a keynote speaker with few restraints on the topic. Naturally my remarks are expected to have some bearing on Canadian monetary policy so they fit in some manner with the rest of the conference. Beyond that, the C.D. Howe Institute generously left the door wide open.

The focus of the conference is on the three areas of research for possible changes to the inflation control regime in Canada for the next agreement between the Government of Canada and the Bank of Canada in 2011. I will address the rate of inflation in the target, price-level versus inflation-rate targeting and the role of monetary policy in asset prices. But I would like to broaden the scope and deliberate on anything that could make monetary policy and its agent in Canada, the Bank of Canada, more effective.

The task of recommending improvements would be a lot easier and more interesting if the Bank of Canada had a history of ineptness. Fortunately for the country, but unfortunately for the sake of my remarks, this is far from the case. The Bank has a history of competence in its people and in its policies. I will go so far as to say it has a history of excellence. For sure it did allow inflation to get out of control in the 1970s. And it did preside over deep recessions in the early 1980s and the early 1990s. But Canada was hardly alone in these experiences. Canada plunged once again into a deep recession in the past few years. But it would be hard to make the case that much of the blame should be laid at the Bank's door.

On the positive side, the Bank has achieved tremendous success in hitting its inflation target over the past 20 years. In fact, its average is bang on. And until Canada got sideswiped by international forces in late 2007, the country had avoided sharp cycles for one and one-half decades, even avoiding the recession the US fell into in the early 2000s.

So unfortunately for any drama I might have been able to create with these remarks, I must confess up front that any changes to Canadian monetary policy and its agent will likely be at the margins. And that includes anything that might be done on the three specific questions being investigated for 2011.

One of the reasons I am keen on taking a broader approach today than the three specific questions is that I don't find them as important now as I did in 2006. That's because back then I thought they were about the only thing to debate in monetary policy. In turn, that belief flowed from being drawn into a false sense of confidence that the achievement of low, stable inflation assured smooth economic performance. Of course, I would not have fallen into this trap had I been a better student of David Laider's history of monetary policy. He has pointed out that many cases of economic instability, including the Great Depression, were not preceded by runaway inflation.

Recent years have brought to the fore a set of questions for monetary policy that seem much more important than at least the first two questions the Bank of Canada suggested for the 2011 renewal, being whether the target should be lowered and whether the focus should be on targeting the rate of inflation or the price level. An element of these more interesting questions was added to the mix when the Bank added the third question concerning the appropriate link between monetary policy and asset prices. But more generally it now seems that the most important questions are the appropriate reforms to financial sector regulation, how the Canadian and world economies will perform under new regulations and what lessons from this crisis should be reflected in the theory, tools and approaches to monetary policy. I will also argue that better understanding Canada's lackluster productivity performance, what to do about it, or at least how to adapt monetary policy to it, rise higher in the order of prominence than the inflation-targeting questions.

The Bank of Canada as an Institution

I will begin with an examination of the Bank of Canada as an institution. I will argue that it is almost unique among Canadian institutions in being highly regarded by most constituencies, including the media, economists, governments and international peers.

In good part that is because it has a history of employing excellent people. Whether at Finance or the TD Bank, a key component of my recruitment strategy was to raid the Bank of Canada. I was occasionally successful. More often, I was not, because people are happy working there. In considering university students I was always curious how they fared through the Bank of Canada interview process. Because I know the Bank is extremely rigorous in its screening processes and only hires the best people.

The Bank could be tagged with a criticism of depending too much on "lifers." Mind you, these "lifers" are first rate. But historically a lot of Bank employees have only worked for that one institution. And related to a point I will make in a moment on communications, they didn't tend to get out of the building much and outsiders didn't get in very often. So the human resource policy contributed to the institution being somewhat insular. In particular, it lacked experience in some markets, including equities and non-public debt.

In defense of the "lifers" it must be pointed out that they could at times show tremendous creativity. The Bank's Financial Stability Review now seems tremendously important. But interestingly, a small group of "lifers" started it as a sideline and on their own initiative.

As with many organizations that expanded greatly in the 1970s, a lot of "lifers" are retiring at the moment. We lament the loss of their experience and their expertise. But it is refreshing to see that the Bank is recruiting for permanent and temporary positions from a broader circle including people with direct market experience. And for several years the Bank has been more active in pursuing employee exchanges in both directions, with more of its employees leaving for a time to gain external experience and outsiders coming in for stints with the Bank.

So I would say that while there may have been some key human resource deficiencies at the Bank, many of these are now being addressed. Still, I wonder whether the Bank has yet got itself into a position whereby the best monetary people in the world would consider the Bank their first choice, over alternatives such as the International Monetary Fund or the Federal Reserve Board. I think the Bank isn't quite there yet. But it is building the blocks on the foundation it needs, namely establishing a record for policy excellence, having an active and transparent research program and high visibility on the international front. Build these, and the world's best will come, I believe.

Receptor Capacity

Any good organization needs to be able to draw upon and be prodded by the work of peers. For example, one could argue that the best way the Canadian and American Women's Olympic hockey teams can improve would be by trying to bolster the lackluster quality of their international competitors. Similarly, a vibrant Bank of Canada needs a vibrant external monetary policy environment.

I have concerns on this front. I recall a meeting in 2006 when the Bank of Canada asked the Chief Economists of the Canadian banks to actively participate in the research on the questions for the 2011 inflation agreement. I think I can speak for all the economists present that we felt an inadequacy for the task. We didn't believe we were up to the standard of the game to be played by the Bank. That's to the shame of the economics community. On one hand it speaks to the superior talents, and resources I hasten to add, of the Bank staff. But ultimately a weak receptor capacity does the Bank no favours.

One can also fret a bit about the academic scene in Canada. When I was beginning to study monetary policy I greatly benefited from the insightful commentaries of Tom Courchene and Peter Howitt. For the most part, both have shifted their talents to fields away from Canadian monetary policy. For decades we have benefited from the monetary policy wisdom of David Laidler and Michael Parkin. Fortunately, they are both still very strong forces on the scene. But there seem few coming to the discipline in the next generation. Some of them, like Chris Ragan and Gregor Smith are here today. I applaud the C.D. Howe Institute for creating a Monetary Policy Chair and for appointing Chris as the first occupant. Even if on occasion Chris were to chastise the Bank, my belief is that the Bank will be the better from such commentary.

The events of the past few years have revealed a glaring weakness in Canadian circles in the field of risk. In particular, there are few Canadian academics doing research in this field. Graduate programs are only one year and don't remotely approach the subject in an integrated fashion. Again such external weakness hurts the Bank of Canada, as well as OSFI. There were few outsiders the Bank or the Government could turn to when they needed to quickly ramp up their own games on risk. To its credit the Bank of Canada brought in the few most likely suspects, like John Chant and Frank Milne.

It was from such concerns that I have pressed over the past two years for the creation of what is now being called the Global Risk Institute. Hopefully, it will sharpen Canadians' and perhaps the world's game on risk management. Ideally, it will create a pool of talent and a body of research that will inform the Bank of Canada in an area where they have not historically had deep expertise. I am enormously appreciative of the support the Governor has given to the GRi and for the wisdom provided by the recently retired Jack Selody as a member of the working group to create this Institute. The Bank now needs to build upon efforts to create opportunities to strengthen the external expertise in monetary and risk issues. No institution likes to lose good people. But the Bank may well have to accept a role as a feeder and trainer to a broader community steeped in financial issues.

Communications

Communications must be an integral part of good policy delivery. Agents must understand what the authority is trying to achieve in order for there to be success. The Bank has had weaknesses on the communications front but great advances have been made.

A few decades ago Canadians rarely heard from the Bank of Canada. There were few speeches, typically only delivered by the Governor, and few public documents that explained policy in any detail. It seems that beginning with John Crow each successive Governor has opened up the communications and transparency of the institution further. We now have detailed monetary policy documents several times a year, many speeches from the Governor and a much larger number given collectively by the other members of the Governing Council and other staff members. One could certainly not now say the Bank lacks visibility.

There does remain one big question in the communications and transparency department. Do the Bank's forecasts have much meaning when the key ingredient, the underlying interest rate track, is withheld from public knowledge? I have always been fascinated by the interest of the media and certain analysts in the Bank's forecasts. They really aren't that interesting. By design, they must show an eventual return to a zero output gap and achievement of the inflation target. The only question is how long it will take to achieve these end points. At least that is the only question the public gets an answer to.

The more interesting question is what interest rate path the Bank of Canada believes necessary to return the economy to equilibrium. Here the public is given little guidance. Without this key ingredient, I would argue the Bank's economic forecasts have little meaning.

All the other veils have been taken off the Bank's forecasts. Like the rest of us, they have to suffer the slings and arrows by sticking their necks out on quarterly predictions. The exchange rate is revealed, even if it is worded as a technical assumption. Despite my historical queasiness about throwing off the last remaining veil, I now believe the Bank should reveal the underlying interest rate track in its projections. Carefully.

Carefully because, of course, there are risks. The media and, yes, many economists and analysts as well, struggle to distinguish between assumptions and commitments. Heck, they even struggle to understand two parts of a conditional commitment. A year ago the Bank committed to keeping the key policy rate down provided the world unfolded as they then anticipated. But amazingly many agents persistently ignored or failed to understand the second part of a pretty simple statement. So we should not be blind to the risks of agents choking whenever the Bank changed interest rates in a manner that deviated from previous forecast paths. Yet to be effective the Bank of course would need to retain the ability to do so.

So why do I now say throw off the last veil and stand out there completely naked? It's not because the Bank staff are now so good looking, although much has been written on that. Rather, it is because I think the Bank and its audience have reached a sufficient, albeit still far from perfect, competence in communications to handle the risks. And the benefits may be enormous. For example, right now it would be tremendously advantageous to drive home that at some point interest rates are going to move up to 3 or 4 percent. People have already forgotten this is the natural or neutral level when inflation is at its target. Showing and explaining it in a public forecast would be a powerful reminder and an appropriate conditioner of expectations. The fact that most people finally get that the Bank does not defend or target a particular level of the dollar, even the levels shown in the Bank's outlooks, gives me some hope this can be managed.

Productivity and Potential Output

A knock I will make against the Bank, in both its analysis and its communications, concerns productivity and hence the level and growth rate of potential output. As the output gap drives the inflation forecast and hence the interest rate path, potential output is every bit as important in the outlook as the projected track of actual output. Few understand this. In part that is because I don't think the Bank of Canada has devoted enough effort to explain it. And in turn, that may because, like the rest of us, the Bank likely simply doesn't sufficiently understand what is going on, or more appropriately, what isn't going on with Canadian productivity growth.

It has been painful observing the Bank over the last few years progressively and frequently knocking down its estimates of future productivity growth. It has always left me wondering why they have clung so long to a wishful view that somehow productivity growth will revive from the lackluster rate of the past decade. But it just isn't happening. We really need to re-double our collective efforts to understand this. But in the meantime we need to face the reality that maybe productivity growth isn't going to spring back. Consequently, whatever the inflation target is set at may be hit with very low actual output growth because that will be all the Canadian productive capacity can handle. Low potential growth, even though not directly a Bank of Canada responsibility, will I believe be the most important issue for monetary policy, as well as other policies, over the next decade. Far exceeding the impact that any changes to the inflation control regime might have.

It is not as though the Bank has made no efforts at communicating this. When David Dodge first started to put a lot of emphasis on potential and the output gap I realized that few understood him. They just couldn't make the distinction between growth rates and levels. I somewhat in jest suggested he needed to give a speech with a giant chart pad beside him so he could draw actual and potential output and highlight the output gap as the residual. I just about fell out of my chair when a week later I turned on CPAC and there was David speaking to the House Finance Committee with a giant chart pad beside him showing actual and potential output and the gap. And recently Governor Carney has been addressing the productivity challenge. But a better understanding and a clearer explanation of its role in monetary policy is still needed.

The Three Issues for 2011

I am getting closer to being ready to address the three specific issues on the table for the 2011 renewal of the inflation target regime. First, let me applaud the Bank of Canada for its thorough and transparent review of these issues. Even if there was no problem rolling over previous agreements, the lack of deeper questioning of the optimal design was troubling. And I also applaud the C.D. Howe Institute for pulling together external analysis on these questions. Even if I have argued that the external capacity is somewhat weak, it has been tremendously helpful to have a layering of the pieces.

Second, I will raise a general framework issue with the Government of Canada and Bank of Canada agreement on inflation targets. When the agreement was originally developed, understandable concerns were expressed about the intrusion of the Government of Canada into monetary affairs. After all, this was much more pervasive than the possibility of issuing a directive. There were even worries that the agreement would lead to a loss of confidence in monetary policy because the Government was less to be trusted in this domain than the Bank. Little is now heard about such concerns. This is likely because the regime has been so successful and, throughout, the Government of Canada has behaved very responsibly. But still, it must be recognized that the Bank of Canada and monetary policy would be very vulnerable if the Government did not agree to "an acceptable" renewal.

I think the 2011 agreement should foresee the possibility of no agreement being achieved at renewal time and protect monetary policy and the Bank of Canada from an ensuing vacuum should this happen. It would be very simple to do this. The 2011 agreement could state that it will remain in place for a certain number of years and if there is no agreement on a renewal at that time, it will continue until there is agreement. In other words, the default option is to continue with the prevailing regime until it is agreed to change it.

Third, I would like to address a historical point. Having been very involved in the original inflation reduction targets from the Finance Canada perspective, I was interested in John Crow's piece for the C.D. Howe on how the regime came about. He speculated that the Government approached the Bank about a regime due to concerns related to the imposition of restraint on civil service wages and the possibility of an inflationary hit from the GST introduction. I think this falls into that camp of assuming that the other side is smarter than it really is. Yes, those were concerns. But no, I do not think either or both would have led Finance to propose a specific inflation reduction regime.

I will put to you that the real reason the Government proposed the regime directly related to then Governor Crow himself. As he notes in his paper, in 1988 he publicly referred to the objective of monetary policy being price stability. But he gave no numerical or specific definition. By early 1990, it became apparent that this was giving rise to a problem. Correctly anticipating a softening in the economy and hence inflation, the Bank of Canada cut the policy interest rate. The dollar plunged. Ultimately the Bank of Canada reacted by forcing one final prime rate hike in a move that at the time, and in retrospect, hardly seemed appropriate. Indeed, the rate cut early that year seemed the right course and should have been maintained, indeed deepened. But the market reaction was a problem.

At Finance we set out to understand that market reaction. We did a worldwide blitz calling analysts, primary dealers and anybody else who might be able to explain the reaction. Whether we asked in Toronto, London or Tokyo, we got a similar answer. Total confusion as to what the Bank of Canada was doing. Canada was a long way from price stability so why in the world was the Bank cutting the interest rate.

From this experience it seemed clear to us that monetary policy was going to be hampered unless and until the inflation objective was more precisely specified. And we felt that in a vacuum, the Bank of Canada would have been pleased to provide that specification. But the Government might not like it. So in a classic proactive defence, the Government brought the suggestion to the Bank that there be an agreement on a set of inflation reduction targets. As pointed out by John Crow, the answer as to the ultimate objective, after inflation was reduced to 2 percent, was left untouched. Given how far inflation was from 2 percent at that time, this shortcoming hardly seemed important back then. Little did we realize how quickly the objectives would be achieved and how this lack of agreement on the ultimate target would rather quickly become somewhat of an issue. Still, the issue has been brushed aside for almost 20 years and life has gone on rather nicely.

That takes nothing away from the importance of now conducting a more rigorous analysis of the optimal inflation target. I have suggested the Bank of Canada has made few major policy blunders. But they do deliver 2 percent losses in the value of money year after year. That creates an economic inefficiency and various social inequities.

This finally takes me squarely to the first question for the renewal. There can be no doubt that "everything else equal", a lower inflation figure, and indeed pure price stability would be best. But as with everything else, nothing else is equal. The lower the target, the more risk there is of dreaded deflation. Since the inflation reduction regime was first struck in 1991, we have witnessed the epic struggles of Japan with deflation and surely want nothing to do with that. Recently, as inflation has approached 1 percent in some other countries, the media and markets have obsessed with the deflation threat.

And the lower the target, the more likely to run into the zero bound interest rate problem. Mind you, recent experience in Canada and in particular the United States and the United Kingdom has demonstrated that monetary authorities aren't quite as helpless at the zero bound as one might have thought. But still, measures such as quantitative easing will likely never be as powerful as simple short-term interest rate changes.

And we should fuss a bit about the statistical bias in the CPI. Naturally we should press ahead and ensure Statistics Canada receives the resources required to reduce this bias. And more work should be done on possible alternatives, some of which have been dealt with in the C.D. Howe paper by Gregor Smith. But for the moment, nothing seems likely to come and replace the simple, old, biased CPI in time for the 2011 agreement. If at some point the measurement bias is reduced, then the target could be adjusted accordingly.

In the meantime, while the interest of purity and simplicity might suggest an ultimate target of price stability, that would deliver effective deflation. Mind you, we shouldn't automatically cast such a notion aside. It is possible that the efficiency gains from such a target could counterbalance some of the other problems. But still, one has to worry about the zero bound problem.

At the other end, it seems silly to contemplate a change for little advance. For example, I would argue that it wouldn't be worthwhile to change the target from 2 percent to say 1 ¾, keeping in mind that any change involves some transitional costs, including a re-education of the public, media and economic agents on the objective. And I wouldn't favour a shift to something like the EU objective where it is less than 2 percent but understood to be just slightly less. That wouldn't accomplish much and is less transparent than the current Canadian regime.

So for practical purposes we are probably talking about possibilities within a range of 0.5 percent to 1.5 percent. I would even say that to distance the regime more from the risk of deflation and the zero bound, the range to be considered is 1 to 1.5 percent. That might not seem a huge deviation from 2 percent, but of course on a cumulative basis it would really add up. But of course with some greater risk of occasional deflation and the zero bound problem.

So would it be worth it? There would be some economic efficiency gains and some reduction in inequities. But most estimates suggest the big gains come from getting inflation down below 3 and maybe 2 percent with diminishing gains after that. That was certainly Finance's reading of the literature in the early 1990s and while further work has been done in Canada and elsewhere, the conclusion seems to remain valid. Interestingly, in the early 1990s one of the costs of inflation came from an interaction of inflation and an unindexed tax system. Therefore, the partial restoration of indexation in the personal income tax might have reduced those costs.

Theory and models seem on balance to be in favour of a lower target but they do not point to large gains and surface risks such as through deflation and the zero bound. Yet a healthy amount of skepticism should always be applied to theory and models. What about practical considerations and actual experience?

I would certainly feel more comfortable in recommending a lower target if we could observe experience here or elsewhere of good overall economic performance with steady inflation below 2 percent. But instead we observe countries with less than 2 percent inflation suffering unacceptable performance. Of course, this observation begs the retort that such an outcome is by design in that most countries anchor inflation performance by setting their target, and hence inflation expectations, around 2 percent. So we might not observe satisfactory performance with below 2 percent inflation until some authority has the courage to lower the target. As a former civil servant I have trouble mustering such courage.

I would also take greater comfort in recommending a lower target if there were some good international company. But if anything, other countries may go the other way and run higher inflation. Egged on, unbelievably, by the quarters of the International Monetary Fund. Certainly I realize that with a flexible exchange rate Canada retains the ability to chart its own path. But still, wimps love company.

By now you will be getting the sense that I don't think there is a sufficiently robust case to be made for lowering the inflation target. The case for the benefits just doesn't seem sufficiently strong to outweigh the possible costs, including re-educating everyone on something they have come to understand very well.

But I would make a change to the current regime. I would suggest modifying or scrapping the reference to the 1-3 percent inflation rate band. It seems to have little meaning and might be downright misleading. First, the mention of a 3 percent figure in an acceptable range seems downright scary. I am not wild about venturing below 2 percent, but 3 percent is surely too high. And the Bank of Canada seems prepared to act long before deviations from 2 percent inflation hit the 1 or 3 percent tails. So what meaning is conveyed by putting the target within this band? I think the band came about because it was thought inflation would be extremely volatile and rarely be around the 2 percent target. But in this era of "The Great Moderation" inflation has been quite stable. Therefore, I think the notion of this wide band should go or at least be better explained.

Price-Level Targeting versus Inflation-Rate Targeting

Let me now turn to the second issue of price-level targeting versus inflation-rate targeting. If the target is 2 percent and actual inflation comes in at 1 percent, should the objective be to return to 2 percent, or to hit 3 percent in order to get inflation back onto the intended path. Should bygones be bygones?

Sorry, but I have to start with the familiar refrain. In practice this might not be that big an issue. Since adopting the 2 percent target, the Bank of Canada has hit it almost every year and on a cumulative basis. So in effect, they have been achieving price- level targeting while focusing on inflation-rate targeting. But still, it is an interesting issue to explore.

In the interest of preserving the value of money and limiting inequities, I can certainly see the case for offsetting an above-target inflation outcome. One wouldn't want to see any upward drift over time in the intended price level. I don't, however, feel the same way about offsetting any under-target inflation outcomes. Why deliberately strive to drive inflation above the target for a period? Keep in mind that inflation will likely only go above target in an environment of excess demand. Why would the Bank want to promote such a condition, with attendant risks that actual and expected inflation might get out of hand? So while I can see some case for price-level targeting, right off the bat it seems to be an asymmetrical case.

Of course a main argument for level targeting is that it can mitigate the zero bound problem, and hence might be a useful complement to any reduction in the inflation target itself. Suppose inflation is running below the target. In theory it would be expected that the Bank is going to strive to drive inflation above the target to compensate. So there should be an expectation of an extended period of low interest rates. This should raise inflation expectations and hence lower effective real interest rates, thus making monetary policy more powerful.

That's all fine in theory. But it only works if agents understand the regime and are convinced the Bank of Canada will follow through. Both seem shaky assumptions. I am not convinced even the Bank's improved communications are up to the task of explaining that the inflation target is x other than for the next while it is y because it was less than or greater than x recently. But don't worry, after hitting y for a while, the target will return to x. Still with me? And would the Bank follow through. How would Bank officials feel about running inflation 1 percentage point above target because it was 1 percentage point below previously. I can see nervous breakdowns. Can't you hear the teeth grinding over the threat to inflation expectations?

I would suggest a much simpler way of strengthening the probability of controlling the level of prices. That would be to extend the period over which the Bank tries to average inflation to the target. At the moment the Bank strives to achieve the average over a 12-month period. This did not receive much attention when the regime was first set out and that hasn't changed much in the succeeding 2 decades. Lengthening this period would conveniently move the regime closer to level targeting without the downsides I raised above.

So on this one, I say nice idea only in theory. In practice, the Bank will probably continue to deliver something akin to level targeting without officially adopting this as an objective. And if it were adopted as an objective, I think the public and economic agents would be lost and the Bank would lose its cool when it came to running inflation above the target rate. So on to the third and last item.

The Role of Monetary Policy in Asset Prices

The needle is still stuck on my record. Nice idea and an important issue to debate. But on a practical basis it probably doesn't amount to much. Because a) the Bank of Canada and the rest of us aren't smart enough to recognize many asset bubbles before they break; b) monetary policy has only the loosest of links to most asset prices; and c) in most cases there is some other policy instrument that would represent a more effective response.

An equity bubble, particularly in ICT (information, communications and technology) stocks, and then the housing bubble in the United States and elsewhere certainly did spark economic havoc. So the issue can't be ignored. But let's consider what monetary authorities might have done differently in both cases. While the plunge in tech stocks did cause economic damage in Canada in the early 2000s, it was nothing like that in the United States where the ICT sector is relatively much larger. So a monetary policy response wasn't called for in Canada. Even in the United States traditional monetary policy moves could have done previous little to affect the equity valuations. Raising interest rates would have exacted other economic costs with little impact on the real issue. Moral suasion, including perhaps from central bankers and possibly regulatory changes to things like margin requirements would have been more effective.

Canada still hasn't had a housing crash like other countries experienced so again there is no clear case that the Bank of Canada should have been raising interest rates to cool the housing market. And if cooling the market had been the desire, it would have been much more effective for the Government to do it by tightening things like down payment and amortization period requirements. Even in the United States a monetary policy response to the ultimate housing sector disaster would have been way down the list in an ordering of optimal policy responses. But the regulatory authorities, including the Federal Reserve Board itself, miserably failed. So monetary policy might have been left as the only and final recourse. In retrospect, there does seem to be a case that in the circumstances, monetary policy should have leaned against the housing surge. But one wouldn't want to be setting out policy mission statements based upon the assumption that all other policy recourses fail.

So in practical terms I think the cases where monetary policy should react through conventional means to asset prices will be few and far between. But recent experience suggests the issue should be addressed in any inflation control regime. I think the appropriate reaction is to acknowledge that in special circumstances where asset markets are behaving in a way that will be prejudicial to overall economic performance, the Bank of Canada may extend the period over which it takes to return to the inflation target. But let me be clear. The inflation target remains the paramount variable. Only the timing would be at play.

Conclusions

Let me wrap up now. I apologize for using a lot of words to come to few hard recommendations. That is the Bank of Canada's fault. Had they messed up more often I would have had more interesting things to say. But that ship is in good shape and the course they have already charted seems, in the main, to be a good one. I do not recommend any fundamental changes to the inflation control regime.

In summary, I say:

1. Continue to broaden the areas from which Bank of Canada personnel are drawn and give more Bank employees experience outside and more outsiders experience inside.
2. Be resigned and indeed committed to the noble cause of strengthening the capacity of financial analysis throughout Canada.
3. Publish the interest rate path underlying the forecast with a very careful communications strategy.
4. Sharpen the focus on productivity.
5. Build into the 2011 agreement that it continues in place until or unless there is an agreement to replace it.
6. Modify or more likely scrap the 1-3 percent bound.
7. Consider extending the 12-month period over which inflation is to average the target.
8. Acknowledge asset price concerns may warrant an extension of the time taken to return to target inflation.

I fear that this would leave a feeling of dissatisfaction among Bank staff. And I sympathize with that. I can appreciate that it would be frustrating to once again leave the question open as to the ultimate inflation target, somehow again implying that 2 percent is good enough. Mind you, only a few people outside the Bank of Canada will share this concern. Some of them are in this room. But still, the Bank staff deserve to feel good about themselves and their mission. And this aspect does leave something to be desired in this regard.

Unfortunately, I don't have a good answer to this. It seems disingenuous to again say that more experience is required before settling on the ultimate target. That line has been in play for 20 years. I may have written it. The Bank could legitimately say that it is turning its attention to meatier issues such as how to raise productivity growth, how the domestic and world economies will perform under new financial sector regulations and how recent experience should be factored into the Bank's models and policy approaches.

I am sorry to say that I can't come up with better lines than that. But I can't be expected to solve all the Bank's problems.

Thank you.