Intelligence MEMOS

From: Steve Ambler and Jeremy Kronick

To: The Bank of Canada Governing Council

Date: January 03, 2019

Re: **Monetary Policy in a Low-Interest-Rate, Low-Inflation World**

The Bank of Canada should restore the important role of tracking the money supply as a predictor of future inflation and economic performance.

In our new book, "Navigating Turbulence: Canadian Monetary Policy Since 2004," we assess the BoC's policies from 2004, through the turbulence of the 2008/09 recession, the recovery and up to the current period. Overall, we give the bank high marks for its stewardship. However, the bank faces key new challenges posed by the current low-interest rate, low-inflation environment that require response.

It is our contention that the successful conduct of monetary policy in today's low-interest-rate environment means giving a greater role to money – in particular, a greater role for quantitative easing. The bank has gradually reduced the attention it pays to money supply, even omitting monetary aggregates from its *Monetary Policy Report*, depriving it of a valuable metric for measuring economic stability.

We also recommend:

- Adopting average-inflation targeting over a longer period than the current 12-month average of monthly inflation rates. If inflation as measured by the longer moving average is lower than the targeted rate, it would enable the bank to correct for this deviation by allowing for inflation above target in the short run.
- A predefined mechanism to provide liquidity in cases when markets require emergency funding. The benefits of such a mechanism, including on-going design improvement and transparency for market participants, outweigh concerns over moral hazard.
- A continued focus on the role that housing and household indebtedness have on monetary policy effectiveness, and the importance of Canada's aging population in understanding how monetary policy is transmitted to the economy.

With lower neutral rates and demographics acting as a brake on the effectiveness of monetary policy, the bank should continue to think about how to make monetary policy more effective in a low-interest rate, low-inflation economic environment.

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