Carney's Bold Entrance, Poloz's Measured Exit

CHRISTOPHER RAGAN

The Globe and Mail
June 5, 2013

Last week was Mark Carney's last as Bank of Canada governor, and this is Stephen Poloz's first. For their employment records, it is a Carney exit and a Poloz entrance. For their policy actions, it is exactly the reverse.

Mr. Carney got monetary policy onto the stage with aggressive actions, and his challenges were responding to an economy that was falling off the cliff. Mr. Poloz's challenges will be getting monetary policy out of the limelight as the economic recovery eventually progresses.

A few weeks into his mandate in 2008, Mr. Carney cut the central bank's target for the overnight interest rate from 4 per cent to 3.5 per cent – long before Lehman Brothers collapsed and the global financial crisis really got under way. Within 14 months, he had pushed the target rate down to 0.25 per cent and, acting behind the scenes, injected lots of much-needed liquidity into the financial system. We were unquestionably in a new economic world, and new policy thinking was required; Mr. Carney rose to the challenge.

By April, 2009, with the Bank's policy interest rate at its lower bound, Mr. Carney prepared for and explained "quantitative" and "credit" easing – policies that turned out to be unnecessary in Canada. Mr. Carney then introduced the "conditional commitment" to keep the Bank's policy interest rate unchanged for more than a year, a pioneering action that reduced long-term interest rates and advanced the debate over how much central banks should say about their likely future actions.

In short, the past few years saw a major economic problem and the need for dramatic and creative policy actions; Mark Carney was bold enough in his outlook and confident enough in his positions that he took the necessary actions and never looked back. Not all governors might have acted the same way.

But now it is 2013 and the world is very different. The challenges Mr. Poloz will face over the next few years will be less dramatic than Mr. Carney's, but every bit as important. If anything, getting the policy exit right will be more complicated than making the bold policy entrance.

Interest rates have been "low for long," and we need to recognize the dangers this generates. Household debt is finally slowing, but it remains quite elevated. House prices are high and still rising, but could fall significantly in the near future. Many investors are reacting to low interest rates by taking on risky investments. All of this points to the need to gradually increase interest rates as a means of ensuring greater financial stability.

But working in the opposite direction is continued sluggishness in output growth and higher-than-normal unemployment. The underlying causes are a recessionary European economy that continues to threaten the world's financial stability, and a U.S. economy that is recovering but not yet on a solid growth path. Canadian firms are sensibly seeing gloomy export prospects and delaying their investment decisions. The excess capacity in the Canadian economy points to the need for maintaining low interest rates for a while longer.

Figuring out how to balance these opposing forces, and when rates need to rise and by how much, will require a Bank of Canada governor who knows the economy's big picture instinctively and can connect the dots that really matter. And in the plethora of data that the central bank examines every day, there are hundreds if not thousands of potential dots. Mr. Poloz has an uncanny ability to see these dots and figure out their meaning. Few people I know can relate the price of steel pipe in Saskatchewan to Germany's corporate balance sheets as well as Steve.

At some point, Canadian interest rates will begin to rise. If this occurs before rates start rising in the United States, the Canadian dollar will strengthen, and this will create another challenge for Mr. Poloz – to explain to Canadian exporters that an appreciation of the Canadian dollar is an expected and desirable part of how monetary tightening slows the growth rate of a quickly expanding economy. This is never an easy or pleasant message for exporters to hear, but few could explain it better than Mr. Poloz. He will emphasize that the Bank must focus on pressures in the overall economy and on the aggregate inflation rate, rather than on the specific situation in individual sectors.

It need not have worked out this way, but the policy challenges for our past and present governors suit their respective personalities quite well. When aggressive policy was necessary, we needed a person like Mark Carney, who is probably most comfortable when taking bold actions. But when difficult trade-offs have to be assessed and nuanced policy adjustments taken and explained – and this is precisely what the next few years will bring – we will need the careful and steady hand of Stephen Poloz.

*****

Christopher Ragan teaches economics at McGill University and holds the David Dodge Chair in Monetary Policy at the C.D. Howe Institute in Toronto.