Joe Oliver Should Let the Bank of Canada Speak for Itself

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Last week in Toronto, while addressing questions about Canada's fragile economy, the federal Minister of Finance was asked whether the Bank of Canada should consider using "quantitative easing" to stimulate the economy. Joe Oliver responded immediately by claiming that it "is not on the table". Whatever the case for the use of this approach to monetary policy, Minister Oliver should know better than to speak about something clearly outside his purview.

For those who don't know, quantitative easing is an approach for providing monetary stimulus that many central banks have used over the past several years, including the U.S. Federal Reserve, the Bank of England, the Bank of Japan, and the European Central Bank. With quantitative easing, the central bank "prints" money – in either its physical or electronic form – and then uses this money to purchase government bonds on the open market. The new money, once circulating in the economy, appears as a liability on the central bank's balance sheet, whereas the new bonds are an equivalent amount of interest-earning assets. Central banks do this when they can no longer use their "conventional" approach of reducing short-term interest rates because they've already reached their effective lower bound.

Despite the language, quantitative easing isn't really "unconventional". Since they were first created, central banks have been in the business of printing money and using it to purchase government bonds. That's exactly what happens behind the scenes when central banks reduce their policy interest rate in an attempt to spur economic growth; the opposite happens when they raise interest rates in an attempt to slow down an over-heating economy. Central banks choose the scale of these balance-sheet changes depending on their assessment of the economic situation.

Back in 2009, the Bank of Canada chose not to engage in quantitative easing. Its assessment at the time was that Canadian banks and financial markets were not impaired as much as those in the United States and United Kingdom. Conventional interest-rate reductions, combined with the fiscal stimulus by the federal government, were seen as sufficient policy actions to deal with Canada's recession. In retrospect, it's hard to argue that the Bank of Canada acted inappropriately.

But that was then, and this is now. Should the Bank of Canada reconsider the use of quantitative easing, as the economy is now likely in the midst of another recession and growth for this year is forecast to be anaemic? We can and should have this debate, and it's very likely that the discussion is currently happening inside the Bank.

Some economists will argue that since the Bank's target for the overnight interest rate is already at 0.5 percent, and the economy is looking very weak, it's appropriate that

quantitative easing be the Bank's next step. This view is strengthened by the federal government's insistence that it will provide no fiscal stimulus and instead stick to its promise of achieving a budget surplus by the end of the current fiscal year.

Other economists will argue that the Bank can no longer provide much stimulus to the Canadian economy because the real problems are lack of investment caused by corporate pessimism and depressed exports to a weakening global economy. More liquidity, lower interest rates, and a weaker Canadian dollar just won't help very much – but will likely worsen our existing problems of rising personal debt and rising house prices.

Finance Minister Joe Oliver can play his best role in this complex debate by staying out of it altogether.

The federal government is the sole shareholder of the Bank of Canada, whose governor is accountable to the Minister of Finance and, through him, to Parliament. But the Bank of Canada is also "operationally independent" from the federal government, and this independence is crucial to the Bank's long-term success in maintaining low and stable inflation. Over many years and across many countries, evidence shows clearly that when elected governments get too involved in the operational details of monetary policy, inflation rises and becomes more volatile.

Finance Minister Joe Oliver should be talking a lot about the current weakness of the Canadian economy, and also about what he is prepared to do – with fiscal policy – to make the situation better for Canadians. But when he faces questions about monetary policy, he should defer to the Bank's governor. To do anything else is to undermine the Bank's ability to make monetary policy in the best interests of the country.

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