



BANK OF CANADA
BANQUE DU CANADA

Canada's experience with inflation targeting

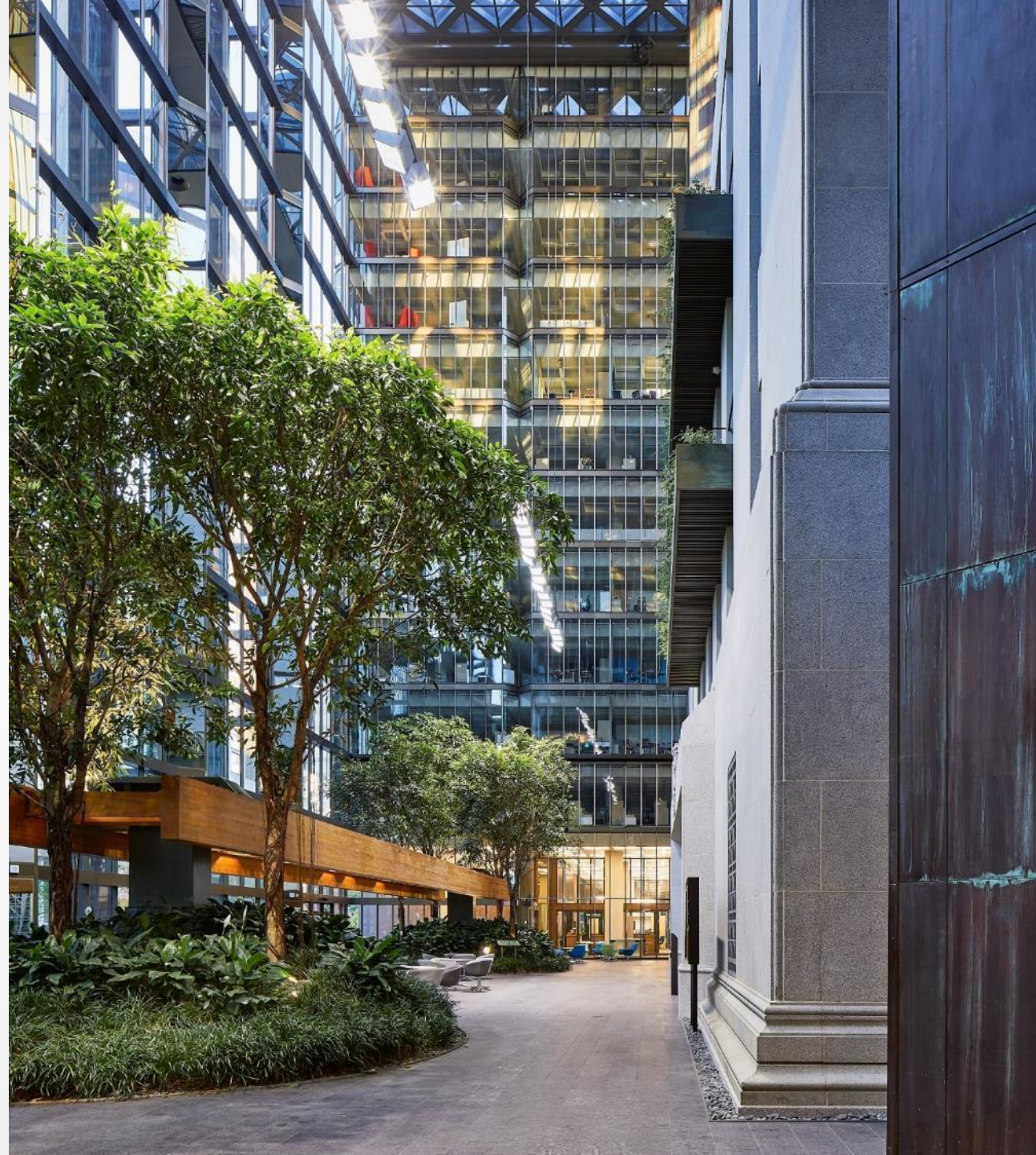
Mikael Khan

Director, Labour and Inflation Team

Canadian Economic Analysis Department

Bank of Canada

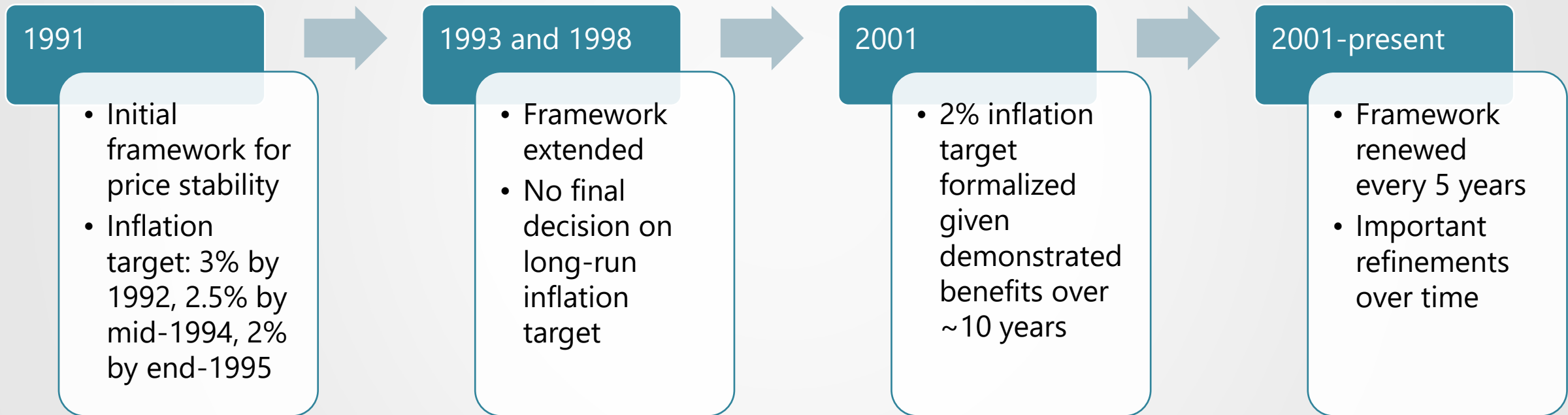
Disclaimer: all views are my own and do not necessarily reflect
those of the Bank of Canada



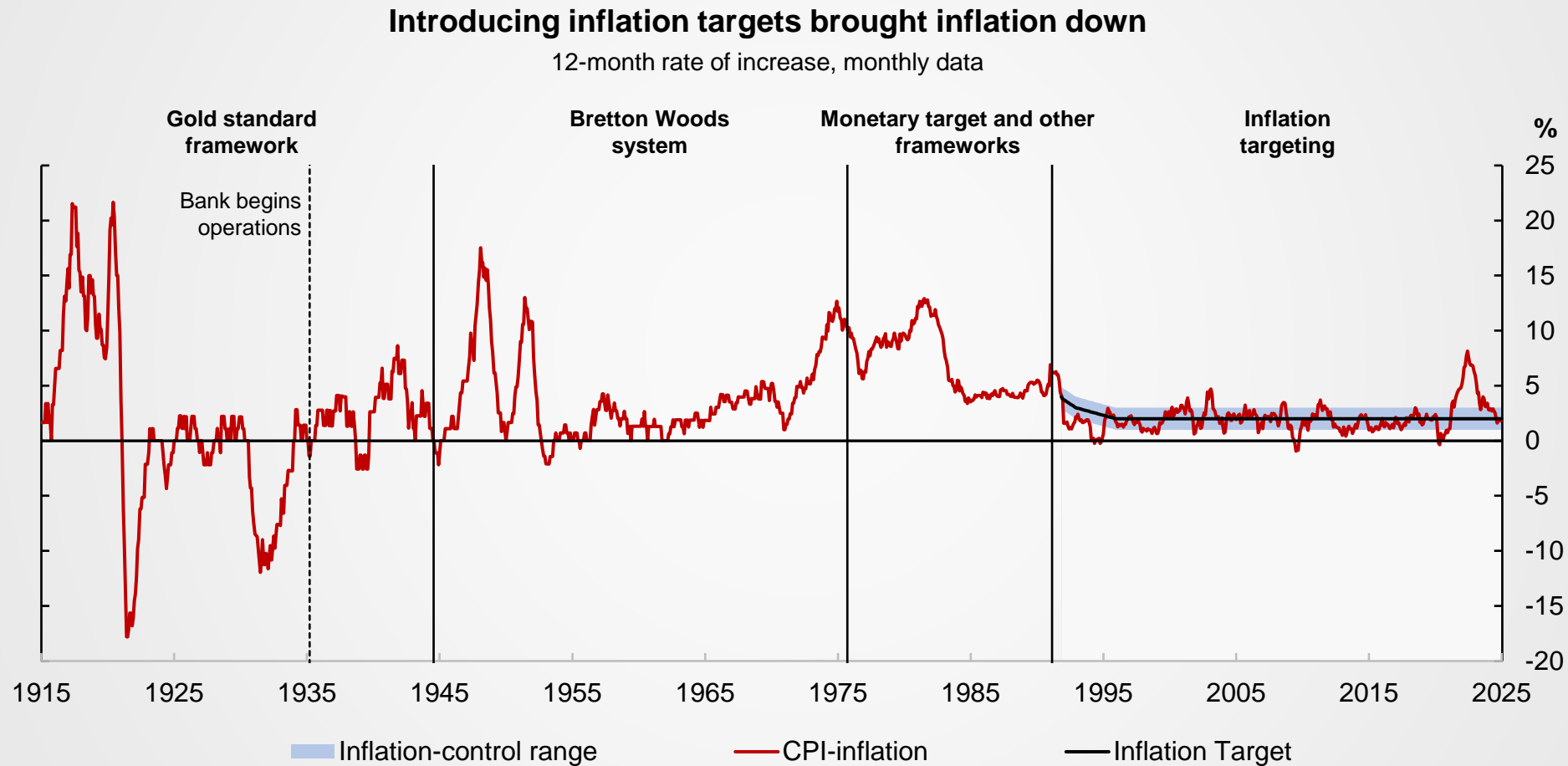
Plan

- A brief history of inflation targeting in Canada
- The 5-year renewal process
 - How it works
 - Recurring issues
- The COVID-19 pandemic
- Looking ahead to the 2026 renewal

Adoption of inflation targeting



Inflation targeting in an historical context



Sources: Statistics Canada and Bank of Canada calculations

Last observation: January 2025

The 5-year renewal process

Research

- Staff analysis of key questions

Outreach

- Consult with stakeholders

Speeches

- Keep Canadians updated on progress

➤ Background document + joint agreement the Government of Canada

Recurring issue #1: the level of the target

- Case for a lower target: Reducing distortions in the economy
- Case against a lower target: more frequent ELB episodes
 - 2011 study: Lowering the target to 1% would make ELB episodes 16 times more likely
- ELB concern trumped potential welfare gains from lower target

Recurring issue #1: the level of the target

- ELB also played a prominent role in the case for a *higher* inflation target
- Two mitigating factors:
 1. ELB itself lower than previously believed
 2. ELB constraint less binding when consider unconventional policies

Recurring issue #2: financial stability

- Pre-GFC: Financial stability not a pressing concern, Bank's role seen as "cleaning" rather than "leaning"
- Post-2008: Increased focus on financial vulnerabilities
 - Elevated household debt and house prices
 - Greater emphasis on "risk management" approach to MP
 - E.g. more flexibility in time horizon over which inflation is returned to target

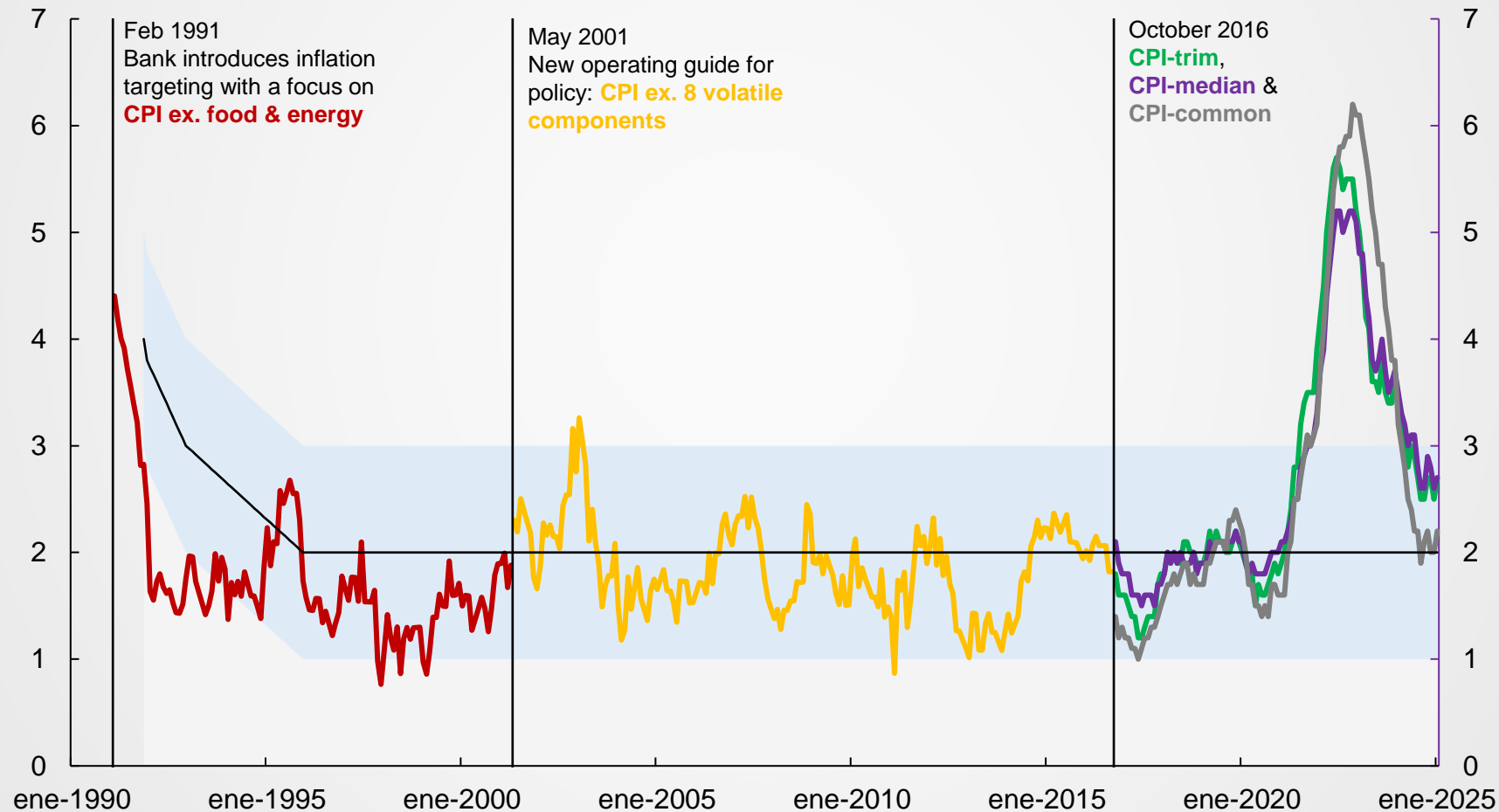
Recurring issue #3: alternative frameworks

- Price-Level Targeting (PLT) – theoretical benefits outweighed by communication challenges
- Average Inflation Targeting (AIT) and dual mandate- key features seen as compatible with existing framework
- 2021: IT framework maintained but with greater focus on labour market conditions



Recurring issue #4: core inflation

The Bank's approach to core inflation has evolved over time



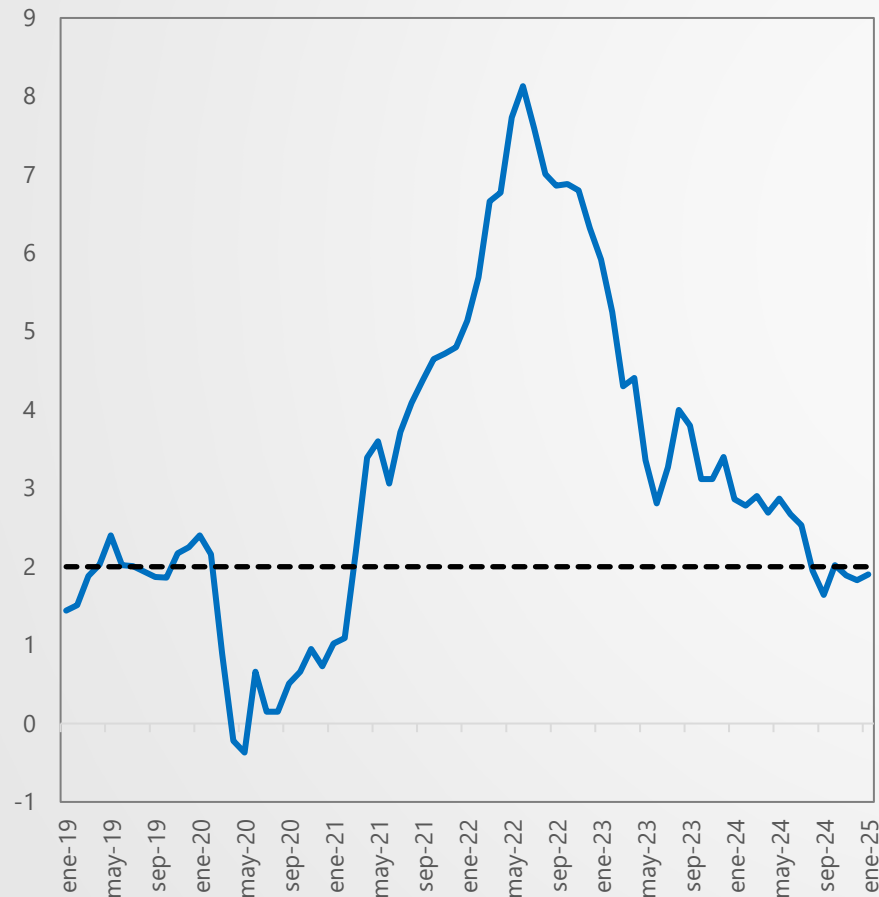
Sources: Statistics Canada and Bank of Canada calculations

Last observation: January 2025

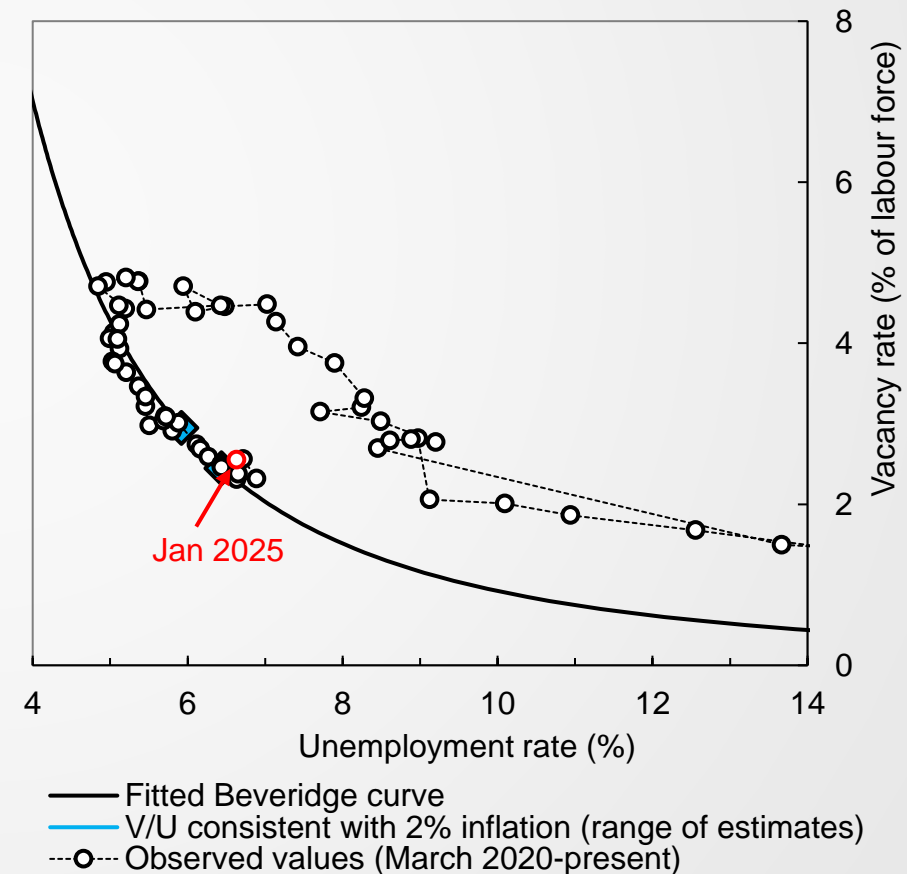
The COVID-19 pandemic (1)

Inflation surged but a soft landing was achieved

Total CPI inflation
Year-over-year %

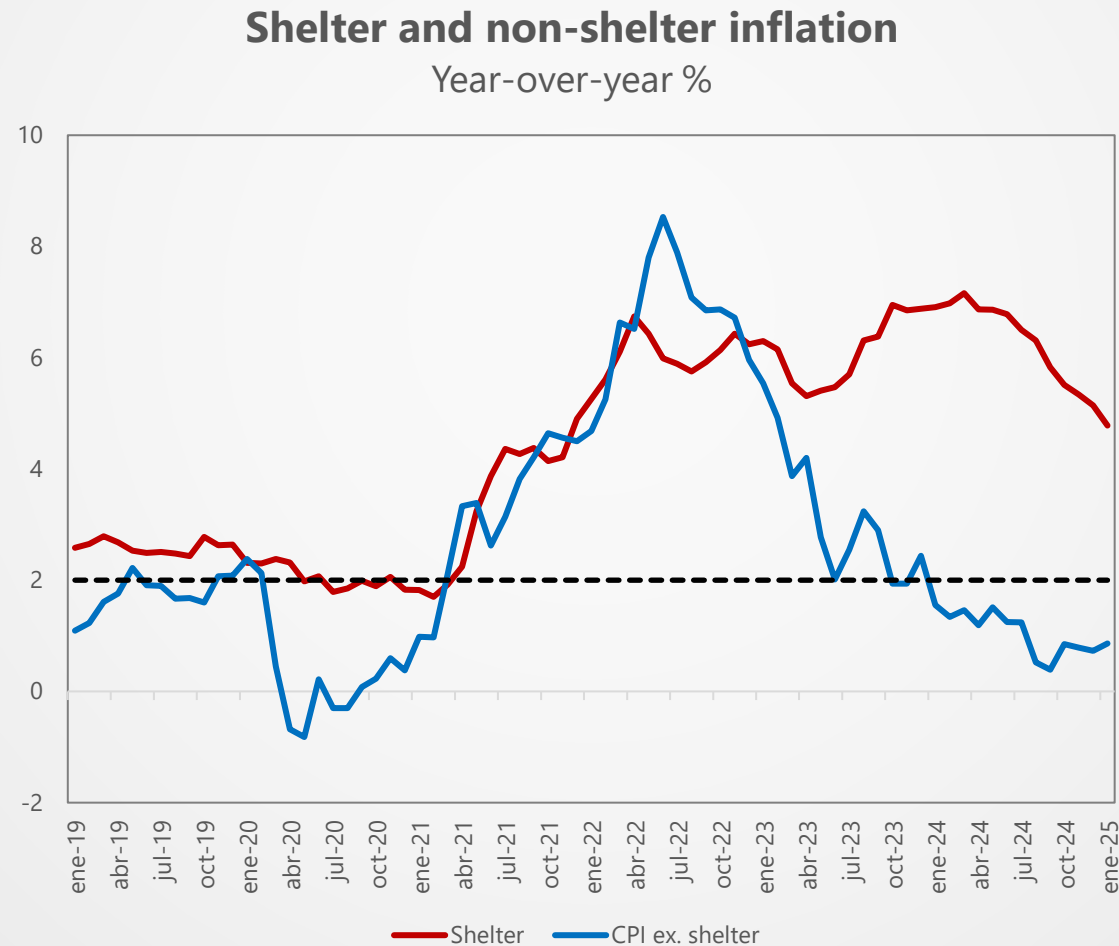


Canada's Beveridge curve



The COVID-19 pandemic (2)

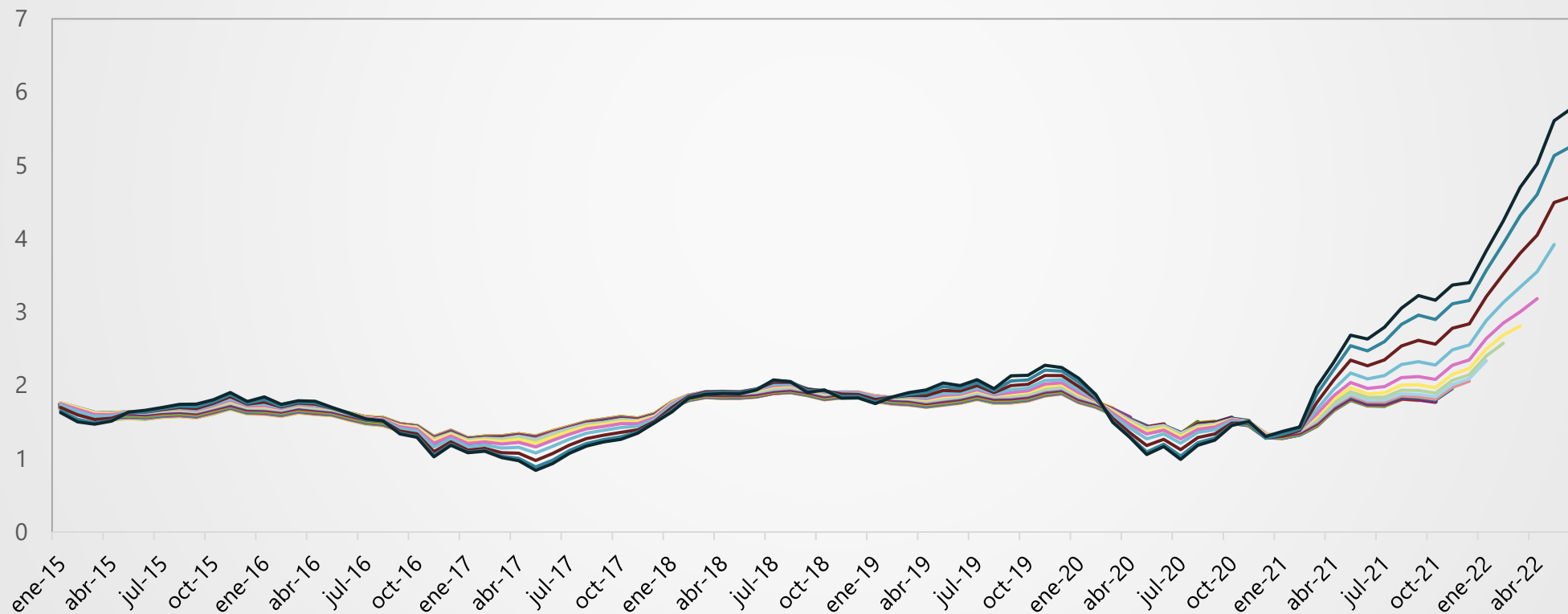
Elevated shelter inflation an ongoing challenge



The COVID-19 pandemic (3)

Factor model-based measure of core inflation became unreliable in real time

Vintages of CPI-common over the pandemic



Note: This chart is generated by estimating CPI-common from January 1990 to December 2019, and then expanding the estimation window one month at a time up to August 2022.

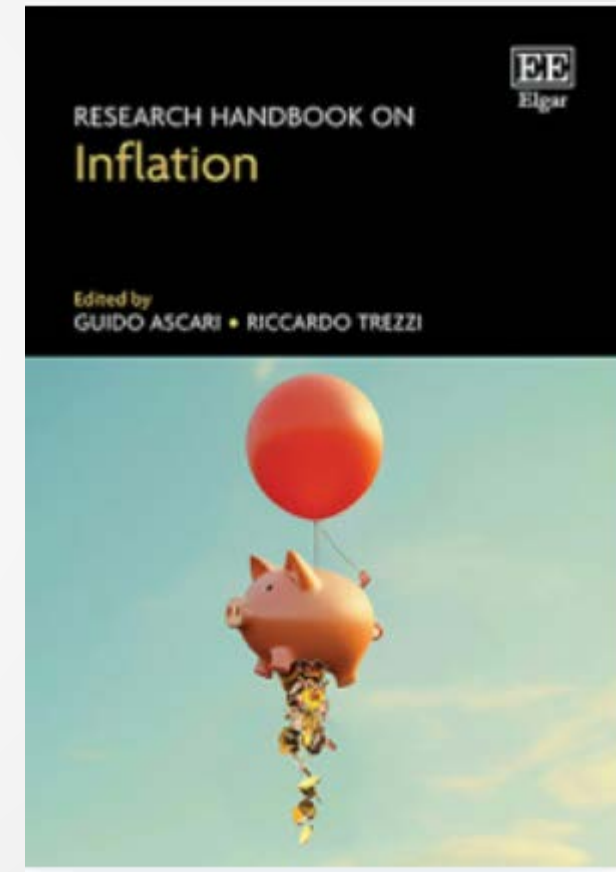
Looking ahead to 2026

3 broad issues for the next renewal:

1. Conduct of monetary policy with structural change + more supply shocks
2. Assessing underlying inflation in a more volatile world
3. Interaction b/w monetary policy, housing imbalances, and shelter inflation

Forthcoming Handbook on Inflation

- Today's presentation draws on a chapter from the forthcoming Research Handbook on Inflation
 - To be published in April
 - Contains many country-specific chapters on inflation targeting





Questions