Economic progress report: keeping markets working

Introduction

The Canadian economy was operating close to its capacity, our national jobless rate was near historic lows, and the inflation rate was right on target. The Bank of Canada had been working hard to keep interest rates at historically low levels, ensuring that our financial system and economy remained strong. We had created a number of programs to ensure our financial system remained liquid and that we could ensure high-quality funding was available to support households and businesses through the downturn. Given the uncertainty surrounding the coronavirus pandemic, the Bank was closely monitoring the financial sector and was prepared to act to support the economy.

The importance of liquidity

In normal times, when it is working well, the government bond market reflects what investors think will happen in the future. But when uncertainty invades financial markets, liquidity can dry up. Market participants become afraid to sell financial assets, and this affirms that prices will fall. The Bank of Canada's task is to ensure that capital markets maintain adequate liquidity so that households and firms can continue to obtain credit.

Programs and tools

First, the Bank of Canada reduced the frequency of its open market operations, which means that it is selling government bonds every day to inject liquidity into the market. This is how we usually manage the level of money in the system. However, with the unprecedented and uncertainty surrounding the coronavirus pandemic, the open market operations were not sufficient to provide liquidity to the market. As a result, the Bank of Canada increased the size of its open market operations, which now amount to $10 billion per day.

Yesterday's decision

Yesterday, we lowered our policy interest rate further to zero percent, and we also increased the level of assets that we will purchase. We did this to support the economic recovery and to ensure adequate liquidity for the financial system. It's important to remember that if we don't take action, the economy will suffer. By lowering interest rates, we make it easier for banks to lend money to the economy.

Funding liquidity: credit for banks, people and businesses

Yesterday's decision changed the rate at which banks can obtain funds from the Bank of Canada. Banks can now borrow funds at the zero percent rate, which is the lowest rate ever. This means that banks can now obtain funds from the Bank of Canada at zero percent interest, and this will allow banks to lend money to people and businesses at lower rates.

Monetary policy

At the outset of the pandemic and within a span of about three weeks, we cut our policy interest rate by 50 basis points on March 3 and by another 100 basis points on March 27. These moves were intended to ensure adequate liquidity for the financial system.

In the early days of the pandemic, when lenders had a hard time accessing cash, they passed along their costs to borrowers. Today, we are seeing the opposite: lenders are giving consumers lower interest rates. However, the economic recovery is still uncertain.

In the first quarter of 2020, GDP fell 1.0 percent, in line with expectations, as the effects of the pandemic took hold. For the second quarter, we are expecting the level of GDP to fall by a much larger amount. This is because we are experiencing a larger decline in consumption and business investment. For the third quarter, we are expecting GDP to start to decline.

In the United States, the economy is expected to continue to decline in the third quarter. The Federal Reserve has lowered its policy rate to zero percent and is buying large-scale assets to support the economy.

In normal times, the world's central banks are concerned about inflation rising too much. But the coronavirus pandemic has led to a sharp decrease in demand, so inflation is now a concern for the Bank of Canada.

In the United States, the Federal Reserve is concerned about inflation falling too much, as it can lead to deflation. In Canada, we are more concerned about inflation rising too much. We are working hard to ensure that inflation remains within our target range.

Inflation targets

Inflation targets are a way for central banks to communicate to market participants about their policy stance. The Bank of Canada uses the inflation target range of 1 to 3 percent as a guide for setting its policy rate.

In the United States, the Federal Reserve uses a symmetric inflation target of 2 percent. This means that the Federal Reserve is committed to keeping inflation at 2 percent, and it will do what it takes to achieve this goal.

In Canada, we also have a symmetric inflation target of 2 percent, but we are more flexible in our approach. We use a target range to accommodate shocks that are temporary and that are not inflationary.

The Bank of Canada is committed to achieving the inflation target in the medium term. We are working hard to ensure that inflation remains within our target range, and we are prepared to do what it takes to achieve this goal.

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The Bank of Canada and the Federal Reserve are both committed to achieving their inflation targets in the medium term. We are working hard to ensure that inflation remains within our target range, and we are prepared to do what it takes to achieve this goal.

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