Toward 2021: Renewing Canada's Monetary Policy Framework

About the Bank of Canada

The Bank of Canada is the nation's central bank. Its principal role is "to promote the economic and financial welfare of Canada," as defined in the Bank of Canada Act. The Bank is a Crown corporation, owned by the federal government, but with considerable independence to carry out its responsibilities.

Core Functions

The Bank has four major functions: conducting monetary policy, overseeing the financial system, issuing bank notes and acting as the government's banker:

Monetary Policy

The objective of monetary policy is to preserve the value of money by keeping inflation low, stable and predictable.

The Bank currently targets 2 per cent inflation, the midpoint of a 1 to 3 per cent target range. First introduced in 1991, the target is agreed to jointly by the Bank and the federal government. That agreement is reviewed every five years.

Financial System

The Bank promotes safe, sound and efficient financial systems, within Canada and internationally. It conducts analysis to identify and reduce risks in the financial system, oversees major payment clearing and settlement systems, promotes financial stability and conducts transactions in financial markets to support these objectives.

Currency

The Bank designs, issues and distributes Canada's bank notes; oversees the note distribution system; and ensures a consistent supply of quality bank notes that are readily accepted and secure against counterfeiting.

Funds Management

The Bank manages funds for the Government of Canada, itself and other clients. For the government, the Bank provides treasury management services and acts as fiscal agent for public debt and foreign exchange reserves.

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Renewal of the Monetary Policy Framework

In 2021, the Bank of Canada and the Government of Canada will renew their agreement on Canada's inflation-control target—that is, how to keep inflation low, stable and predictable. First signed in 1991, the agreement is reviewed and renewed every five years.

Before every renewal, the Bank undertakes a wide-ranging research and public consultation process to recommend to the government how we should carry out our responsibilities to promote the economic and financial welfare of Canada.

Inflation measures changes in the amount of goods and services that a dollar can purchase. The Bank of Canada tracks inflation using the Consumer Price Index (CPI), which measures how the prices of goods and services bought by an average Canadian household rise over time.

Lots of factors affect prices—how difficult a product is to find, the cost of labour and raw materials used to make it, and competition among those selling it, to name a few. Policies that stimulate economic growth can cause inflation, too: when people have more money in their pockets, they may want to buy more products and services, and that increase in demand can push prices up.

The importance of a stable rate of inflation

The economy works best when inflation is low, stable and predictable. This allows Canadians to plan, save and spend with confidence, and seek wages that keep up with the cost of living. It also allows Canadian companies to plan their budgets for the following year by making assumptions about how much the price of supplies, rent and employee salaries are going to go up. When these costs rise, companies tend to raise prices as well. High inflation means that prices are climbing quickly and our dollars don't stretch as far. High inflation weakens our purchasing power—the ability to buy products and services with the money we have.

The Bank's role in keeping inflation stable

To achieve the inflation target, the Bank raises or lowers interest rates. If inflation is too high, the Bank may raise its policy rate, which is the interest rate at which the Bank expects financial institutions to lend to each other. This prompts commercial banks to increase interest rates on their loans and mortgages, for example. Higher interest rates encourage savings and discourage borrowing and, in turn, spending. In response, companies increase their prices more slowly or even lower them to encourage demand for their products and services. This helps bring inflation down.

A lower policy rate works in the opposite way: it prompts commercial banks to lower their interest rates, which discourages savings and encourages borrowing and, in turn, spending. Ultimately, lower interest rates help push up inflation.