Inflation levels of the bank of canada

Finance, Banks

The government of Canada is responsible of providing a legal system, promoting competition, providing public and most importantly promoting economy wide stability. This is done via multiple actions, policies and laws put in place so that the population can thrive. In this text, I will argue why the Bank of Canada may choose to target a low by non-zero, positive rate of inflation. I will take a look at the meaning on the varied factors involved and argue why the bank might choose to do so.

Firstly, the bank of Canada was created in order to " promote the economic and financial welfare of Canada (Kenton, 2019). The bank's role is to print money, set monetary policies and to determine the Canadian banks' interest rates. These tasks require careful analysis in order to keep the economy stable. One of the key targets for the bank of Canada is the keep the inflation rates at a stable level. For various reasons, the bank might choose to target a low positive rate of inflation but to not set it at zero. To start, low inflation presents multiple advantages compared to high inflation rates. First, low interest rates allow consumers and businesses to make better long-term plans because their purchasing powers will remain stable over the years instead of declining (Bank of Canada, 2012). After, a lower inflation rate allows the nominal and real interest rate to reduce the cost of borrowing money (Appelbaum, 2015). This allows Canadians to buy more and therefore stimulate the economy. In terms of companies, they will invest further in order to increase their productivity over time. (Pettinger, 2016). Furthermore, the current inflation target set by the Bank of Canada is at 2%. This target created in 1991 and is called the " Agreement on the inflation-control target" (Bank of Canada, 2016). This rate allows the Bank of Canada to carefully maintain the economy and judges that the inflation rate is optimal and suits our economy the best.

Secondly, an inflation rate of 0% is judged to be not advantageous by the Bank of Canada. As a matter of fact, multiple arguments against the 0% inflation rate target can be made. First, a zero-inflation target is risky because once the inflation rate is set at 0%, the bank cannot allow the rate to fall in the negative. A negative inflation rate may result in people expecting low economic growth which might yield less investment therefore people will avoid holding cash. (Martin, 2016). Another argument is the fact that zero inflation rate diminishes the bank’s ability to stimulate the economy since the policy interest rate is limited since the nominal interest rates that banks charge the lender cannot be negative (Martin, 2016). Also, this encourages people to spend and borrow capital instead of saving it (Billi, Kahn, 2008). Lastly, the financial authorities lose the ability to offer negative interest rates because they cannot allow the real inflation to fall in the negative. (Johnston, 2019).

Thirdly, high inflation rate might hinder the Canadian economy. In fact, one of the consequences of high inflation rates is an increase in the cost of borrowing money and higher mortgage interest payments (Pettinger, 2019). These high rates will discourage people to borrow money and spend, it will also increase the monthly mortgage payments of borrowers therefore decreasing their ability to spend money. Next, although people will be more inclined to save money, it also means that they will spend less and inject less into the economy since the interest rates will generate more revenue by saving up (Pettinger, 2019). For example, a stable economy usually sets inflation rates between 2 and 4 percent since it has been proven that it is more stable. It has been shown that a high inflation and interest rate does not result in lasting gain in regard to economic output and employment (Riley, 2019). Further, high inflation promotes more speculative investments and deteriorates more productive investments (McCallum, 2011). It will also create a false temporary financial health, but it will mask the real economy problems (Pettinger, 2019). Then, buyers will spend more of their income to try and shield themselves from increased costs and prices. In the meanwhile, businesses will increase their prices, interest rates and wages in response to the increased inflation. Last, high inflation will affect people whose salary are not keeping up with the increase of price, such as retired people with pensions.

In conclusion, adhering to a low rate of inflation allows the Bank of Canada to keep the economy stable while still allowing economic growth along with keeping interest rates affordable for borrowers. Zero percent inflation rate hinders the economy because the bank is unable to stimulate the economy by using traditional methods, people will also avoid holding cash since it will yield low returns and a going towards a negative inflation level is detrimental to the Canadian economy. After, high inflation rates discourage people to borrow money, leads to speculative investments over more productive methods. The interest rates will go up along with mortgages. Finally, a low inflate rate is ideal for our economy and is the ideal strategy employed by the Bank of Canada.

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