Intelligence MEMOS

From: Jeremy Kronick

To: Stephen Poloz

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Re: **Bank of Canada Options for Minimizing US Election Fallout**

There is already clamoring, in light of President-elect Trump's stunning victory, for you to cut rates at the next meeting of the Governing Council on December 7. The argument is as follows: President-elect Trump has generated falling business confidence and an increase in uncertainty, and as such the Bank of Canada should respond by lowering interest rates to stimulate bank lending, cause a fall in the loonie that will boost exporter profitability, and hopefully keep the Canadian economy close to operating at its potential.

But I urge you to instead consider other measures for keeping the Canadian economy on track and providing more certainty to markets.

As we saw during the Great Recession, when uncertainty prevails in the market, banks are skittish about increases in lending, even at lower rates. With Dow Futures crashing 750 points at one point during the election, yet general trading results positive the next day, it's clear that uncertainty prevails. Therefore, a key result justifying a loosening of monetary policy seems unlikely to materialize.

Uncertainty is also a realistic concern in hoping for a boost in trade. A byproduct of lower interest rates is a depreciation of the Canadian currency relative to the US dollar and thus an increase in export competitiveness. However, businesses make decisions when they have certainty regarding future prospects. Trump's trade agenda is unlikely to materialize for months meaning that many businesses may be hesitant to enter into any long-term contracts now. If this is the case, the expected trade benefits from lowering the overnight rate target may not materialize

The downsides of looser monetary policy are clear, however, and have been repeatedly stated by outside commentators as well as by you and your colleagues at the Bank. Chief among them is a continual fueling of cheap credit growth.

So what can you do instead to provide comfort to Canadians? The Bank of Canada has a strong set of emergency liquidity tools in place to support the economy should markets seize up in response to negative shocks. The normal day-to-day emergency liquidity toolkit consists mostly of overnight repurchase agreements that provide instant liquidity to different institutions across the financial sector spectrum Additionally, the Bank has always reserved the right to bring back the longer-term market-wide emergency liquidity measures it introduced during the Great Recession of 2007-2009. These tools served the Bank of Canada well during that period by ensuring that the economic turmoil that existed at the time did not stop the functioning of Canada's financial system, thus preventing widespread contagion.

The important thing at first should be to assure Canadians that the Bank stands ready to act at a moment's notice and will do what it takes to ensure that any market turmoil does not turn into a systemic economic breakdown. Better to remind markets of the powerful tools at your disposal than to lower interest rates even further, which would fuel more credit growth and generate uncertain returns, at best.

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