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The Benefits of Low Inflation

THE BANK OF CANADA CONDUCTS MONETARY POLICY with the aim of harnessing the many benefits of keeping inflation low and stable — and thereby maintaining a more favourable climate for long-lasting economic growth and job creation.

High inflation has many costs

- Inflation erodes the value of money. When future prices are less predictable, sensible spending and saving plans are harder to make. People increasingly fear that their future purchasing power will decline and erode their standard of living.
- Inflation encourages investments that are speculative and take advantage of inflation rather than productive investment. It can also create the illusion of temporary financial success while masking fundamental economic problems.
- Businesses and households must spend more time, and money, protecting themselves from the effects of rising costs and prices. Businesses, workers, and investors respond to signs of inflation by pushing up prices, wages, and interest rates to protect themselves. This can lead to a "vicious circle" of rising inflation.
- Inflation can mean particular hardship for those whose incomes don't keep pace with the rising level of prices, especially people on fixed incomes such as senior citizens who are receiving pensions.

Low inflation has many benefits

- Consumers and businesses are better able to make long-range plans because they know that their money is not losing its purchasing power year after year.
- Interest rates, both in nominal and real terms, are lower, encouraging investment to improve productivity and allowing businesses to prosper without raising prices.
- Sustained low inflation is self-reinforcing. Businesses and individuals do not react so quickly to short-term price pressures by seeking to raise prices and wages if they are confident that inflation is under long-term control. This contributes to keeping inflation low.

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Figure 6.5 *The Federal Reserve System can speed up or slow down the economy by controlling the money supply.*