A number is not yet credibility

Canada's inflation targets, 1991-2001

Country decision case | Economic policy | 9 October 2026

The hook

Canada announced a path toward low inflation in February 1991. Inflation fell faster than expected, but the economy was weaker than expected too. A target could clarify policy without instantly convincing households or markets. The decision was how to turn a public number into an operating discipline while confronting the costs of adjustment. [S1, S3, S5]

Abstract

Canada introduced explicit inflation reduction targets in 1991, linking the central bank and government to a published path toward price stability. Inflation fell rapidly, but the announcement did not instantly establish credibility, and disinflation coincided with recession and a slow recovery. This case distinguishes the target, the operating tools and the measured outcome. Original policy documents show gradual milestones, tolerance bands and attention to exceptional price shocks. Contemporary reporting explains how forecasts, interest rates, exchange rates and communication supported implementation. Official price indexes document lower inflation; they do not identify the target's independent causal effect. Institutional retrospectives and an external assessment differ in emphasis on credibility and adjustment costs. For Sri Lanka, the conditional lesson is to connect a clear objective to dependable institutions, fiscal consistency, usable evidence and public explanations. Copying Canada's number alone cannot guarantee stable prices, a painless transition or the same economic outcome under different conditions.

The decision question

When actual inflation falls ahead of schedule but activity remains weak, should policymakers celebrate, ease policy, or first distinguish lasting credibility from a temporary demand shortfall?

Independent teaching case. Not an HBS publication. Policy choices and Sri Lankan lessons are labelled judgment. This is a historical evaluation, not investment advice or a statement of the latest Canadian policy rate.

1. What was promised in 1991

The original February 1991 announcement, reproduced in the Bank of Canada Review, set out a downward path for the year-over-year change in the consumer price index. The targets were 3% by the end of 1992, 2.5% by mid-1994 and 2% by the end of 1995, with a band of one percentage point on either side. The intended objective after 1995 was further reductions toward price stability, whose exact operational definition was left open. [S1]

That is different from saying Canada permanently selected today's framework unchanged in 1991. In the original document, 2% was an interim destination, not necessarily the final definition of price stability. The subsequent decision to retain a 2% midpoint belongs to the history of learning and renewal, not the initial promise alone. [S1, S4, S7]

Exhibit 1. Announced milestones

End-1992: midpoint 3%; surrounding range 2-4%.
Mid-1994: midpoint 2.5%; surrounding range 1.5-3.5%.
End-1995: midpoint 2%; surrounding range 1-3%.

Ranges shown here are desk arithmetic: midpoint plus or minus one percentage point. These are targets for twelve-month CPI changes at specified dates, not calendar-year average inflation targets. [S1]

The problem behind the number

Canada faced upward pressure from oil prices following Iraq's invasion of Kuwait and from the introduction of the goods and services tax. The Bank's later account explains that policymakers wanted to prevent those shocks from turning into persistent increases in inflation expectations while reducing inflation over the medium term. It also notes a broader history of difficult inflation control. [S3]

Judgment: the announcement sought to make a future path legible. It gave businesses and households a way to interpret wage, price and financing decisions. But a visible number cannot by itself prove policymakers will accept the actions needed to deliver it, or that other government policies will be consistent with it.

2. The choices behind implementation

The following alternatives frame the teaching decision. They are not claimed to be a verbatim cabinet debate.

Rely on a general commitment to low inflation. Benefit: flexibility without an explicit timetable. Risk: people cannot easily distinguish temporary tolerance of inflation from abandonment of the objective.

Commit to immediate numerical success. Benefit: a strong public signal. Risk: demanding rapid correction after tax or commodity shocks could intensify adjustment costs, while claiming victory from a short-lived price fall could damage credibility later.

Publish a path and explain the response. Benefit: a measurable medium-term commitment with room to handle shocks. Risk: the forecast and explanation can become excuses unless departures, tradeoffs and corrective actions remain visible. The historical framework is evaluated against this alternative.

A target needs an instrument and a forecast

The 1995 Monetary Policy Report describes a clear objective, a medium-term perspective and transmission through both interest rates and the exchange rate. The lag between action and inflation matters: waiting until a current inflation reading is too high can mean acting after underlying pressure has already accumulated. Forecasting is therefore part of implementation, not a decorative appendix. [S2]

The report also discusses uncertainty in estimating potential output and the economy's spare capacity. Policymakers could not observe the future inflation rate or sustainable output directly. Judgment: an explicit target disciplines those estimates but does not make them accurate. A sound explanation should show what evidence would change the policy view. [S2]

An IMF working paper describes operational changes: from June 1994 the Bank focused on keeping the overnight interest rate within a 50-basis-point range; in February 1996 the Bank Rate was placed at the upper limit of that operating band. The authors interpret these changes as efforts to reduce uncertainty and improve transparency. An inflation target and an overnight-rate operating range are different objects. [S5]

Communication became part of execution

The May 1995 report was the first in a semi-annual series. Publishing a report made the outlook and policy reasoning available for scrutiny. It was not a guarantee of correct forecasts, and its contemporaneous projections should not be read as subsequent actual outcomes. [S2]

3. What happened to measured inflation

Exhibit 2. Official annual-average all-items CPI

Statistics Canada archived Table 12; index base 1992=100. These historical published values are shown as one internally consistent vintage, not substituted silently with a later rebased series. [S6]

1990: index 93.3; published annual change 4.8%.
1991: index 98.5; published annual change 5.6%.
1992: index 100.0; published annual change 1.5%.
1993: index 101.8; published annual change 1.8%.
1994: index 102.0.
1995: index 104.2.
2000: index 113.5; published annual change 2.7%.

Desk calculation. The annual-average price index rose about 5.79% between 1991 and 1995: (104.2/98.5 - 1) x 100. Lower inflation did not mean consumer prices returned to their 1991 level. Disinflation slows price growth; it is not the same thing as deflation. [S6]

A crucial measurement distinction

The targets refer to twelve-month CPI changes at particular dates. Annual-average index changes compare the average of twelve monthly readings with the previous year's average. Exhibit 2 therefore describes the change in the price environment, but it does not establish exact compliance at the end-1992, mid-1994 or end-1995 milestones. [S1, S6]

The Bank's 1998 retrospective supplies another perspective: twelve-month total CPI inflation was 6.8% at the February 1991 announcement, fell rapidly, and was below the lower edge of the target range for much of 1992. This is consistent with rapid disinflation, while avoiding a false comparison between that monthly reading and the 1991 annual-average rate of 5.6%. [S3]

Why a low reading can mislead

The 1995 report distinguishes broad and underlying inflation measures and examines one-off effects, including tobacco tax reductions. A tax-driven price-level change can lower measured inflation temporarily without proving that persistent pressures have disappeared. Conversely, a one-off increase can raise headline inflation without establishing a permanent acceleration. [S2]

Judgment: keep the official headline objective visible while explaining the sources of temporary movement. Do not switch the success metric after seeing an inconvenient number.

4. The cost and credibility problem

The 1998 Bank retrospective explicitly says the speed of the 1991 inflation decline was surprising and reflected a much more severe economic slowdown than the Bank or most forecasters expected. It points to international weakness, declining raw-material prices and the unwinding of domestic asset-price and debt distortions. These are its explanations, not this case's independent decomposition of the recession. [S3]

The same account says the initial announcement was unlikely to have had a significant immediate effect on expectations. Sustained realized low inflation since 1992 mattered more. This is a useful qualification from the institution itself: even a clear, jointly announced target did not instantly create trust. [S3]

An external assessment adds friction

The 1997 IMF working paper finds that inflation fell quickly, but expectations took a relatively long time to decline, with substantial costs in foregone output and employment. Its indicators suggested near-term credibility had become established while long-term credibility was not yet firmly established. This is the paper's assessment at that date, not an IMF institutional verdict or a timeless conclusion. [S5]

The Bank's 1998 account acknowledges a less vigorous recovery and subdued domestic demand until mid-1996. It disputes explanations putting the entire weakness on inflation targeting, emphasizing restructuring and fiscal, political and external conditions. Those explanations and the IMF paper's attention to costs are kept together rather than averaged into a claim that the transition was painless. [S3, S5]

Fiscal credibility was not separate from the story

The Bank's retrospective links durable reductions in short-term interest rates after 1995 to improved fiscal credibility and reduced uncertainty following the Quebec referendum campaign. It concludes that low inflation was important but not sufficient for good performance. Monetary success did not automatically remove other obstacles to investment and demand. [S3]

What cannot be concluded

A fall in inflation after an announcement is not an estimate of that announcement's independent effect. The economy was already changing; monetary actions, demand weakness, taxes and external prices interacted. This case does not calculate a sacrifice ratio or a counterfactual recession path. It also does not establish that every household bore equal adjustment costs.

5. Learning, renewal and transfer limits

By January 2002 the Bank's retrospective described lower volatility of inflation and real activity during the preceding decade and credited both stronger credibility and a forward-looking framework. Those are institutional interpretations of a historical comparison, not a controlled causal experiment. Different global conditions or domestic reforms could also influence the comparison. [S4]

The December 2021 joint renewal retained 2% as the midpoint of a 1-3% control range through 31 December 2026. It described price stability as the primary objective and maximum sustainable employment as not directly measurable and largely determined by non-monetary factors. It also provided for use of flexibility in the range and reporting on labour-market considerations. This case cites that published agreement, not an unverified future renewal or current inflation reading. [S7]

Conditional lessons for Sri Lanka

Connect the promise to the institution. Judgment: a clear number needs the authority, operating tools, analytical capacity and public accountability to support it. Announcing a target without dependable execution risks another broken promise. Canada's exact percentage is not automatically the appropriate Sri Lankan choice.

Make fiscal consistency explicit. Judgment: assess whether financing needs and policy commitments undermine the monetary objective. Canada's retrospective illustrates that low inflation alone cannot repair broader credibility. This is a transfer hypothesis, not a new empirical diagnosis of Sri Lanka's current fiscal stance.

Separate shock explanation from excuse. Judgment: publish headline inflation, explain tax and supply shocks, and identify what would signal persistence. Preserve the measure through good and bad months. Distinguish annual averages, twelve-month changes and cumulative price levels.

Explain timing and uncertainty. Judgment: state the expected transmission horizon, alternative scenarios and why a decision responds to projected pressure rather than only today's reading. Acknowledge forecast error instead of implying a precise target gives precise control.

Keep adjustment visible. Judgment: track employment, wages, credit conditions and distributional pressures alongside inflation. Do not promise costless disinflation; do not treat every cost as proof that the objective should be abandoned. Separate support for affected people from measures that recreate persistent inflation.

Decision. Prefer a clear, reviewable commitment with consistent institutions and transparent implementation over either vague reassurance or rigid monthly scorekeeping. The record supports that disciplined question, not a guarantee that Canada can be copied.

Sources and method

All sources inspected 9 October 2026. Original announcements and contemporary reporting establish commitments and implementation. Official archived statistics document price outcomes. Later Bank accounts and an IMF working paper are attributed assessments; no independent causal decomposition is claimed.

S1. Bank of Canada Review, March 1991. Original inflation-reduction announcement and background. Targets, bands and the still-open definition of price stability after 1995. Scanned text checked for the milestone figures.
https://www.bankofcanada.ca/wp-content/uploads/2011/12/bocreview-mar1991.pdf

S2. Bank of Canada, Monetary Policy Report, May 1995. Contemporary first semi-annual report. Objective, forecast horizon, transmission, spare capacity and temporary price effects. Filename contains April; the report is presented by the Bank as May 1995.
https://www.bankofcanada.ca/wp-content/uploads/2010/04/mpr_apr_19951.pdf

S3. Bank of Canada, October 1998. The Canadian Experience with Targets for Inflation Control. Institutional retrospective; recession, expectations, recovery and fiscal credibility. Attributed explanations, not independent proof.
https://www.bankofcanada.ca/1998/10/canadian-experience-targets-inflation-control/

S4. Bank of Canada, January 2002. Inflation Targeting in Canada: Experience and Lessons. Later institutional assessment of implementation and volatility; claims remain attributed.
https://www.bankofcanada.ca/2002/01/inflation-targeting-canada-experience-lessons/

S5. IMF Working Papers 1997, No. 171. Original assessment of Canada's monetary-policy framework and credibility indicators. Working-paper judgments on near- and long-term credibility, output and employment costs and the operating framework; not an institutional endorsement.
https://www.elibrary.imf.org/view/journals/001/1997/171/article-A001-en.xml

S6. Statistics Canada, archived Table 12. Consumer price indexes, 1992=100. Historical all-items annual-average index and displayed percentage-change column. An archived official vintage, not the latest monthly series. Calculations use the displayed rounded index values.
https://www150.statcan.gc.ca/n1/pub/11-210-x/00000/t/4098041-eng.htm

S7. Government of Canada and Bank of Canada, December 2021. Joint statement renewing the monetary-policy framework through end-2026. Target definition, employment and flexibility. No claim about a subsequent renewal.
https://www.bankofcanada.ca/2021/12/joint-statement-of-the-government-of-canada-and-the-bank-of-canada-on-the-renewal-of-the-monetary-policy-framework/

Calculations and limits. Target bands are midpoint plus or minus one percentage point. Cumulative price change: (104.2/98.5 - 1) x 100 = 5.79%. No estimate of target-caused GDP gains, net welfare, equal household effects or an optimal Sri Lankan inflation target. Teaching alternatives and transfer lessons are explicitly judgment.