Q. Reference: Dr. Cleary Evidence, Page 11: Please explain if Dr. Cleary believes the current interest rate environment is atypical. The explanation should include a full description of the factors contributing to this environment.

A. Obviously interest rate levels are extremely low today, and well below historical norms. There are numerous reasons for the low interest rate levels in Canada, the major reasons for which are included in Dr. Cleary's testimony on pages 5-12 of his evidence.

The contributing factors include, but are not limited to:

1. Low, but positive forecast economic growth at the global level, which will be the result of diverging prospects at the individual country level.
2. The U.S. Federal Reserve's monetary stimulus policies had a significant impact on both short and long-term rates. The Fed has begun withdrawing this stimulus, which to date has had only a minor impact on Canadian interest rates.
3. While the U.S. begins withdrawing monetary stimulus, other countries such as Japan and the Euro area have turned to even more accommodative monetary policies, contributing to low interest rates.
4. The factors above have contributed to low rates on Canadian bonds by leading to low rates overall globally. Also, since Canada maintains an AAA debt rating, and with uncertainty in certain global regions, there has been an associated "flight to quality," which has also been experienced by German bonds for example. This flight to quality leads to higher bond prices, and lower corresponding yields.
5. Finally, three of the main stories contributing to this divergence of global fortunes have been the falling price of oil, the decline in other commodity prices, and the continued strengthening of the U.S. dollar. These stories have had a similarly diverse impact on the Canadian economy. In response to slower than

expected economic growth, the Bank dropped the Bank rate twice in 2015 (25 basis points each time), also contributing to maintaining low interest rates.

Dr. Cleary concludes by noting that since the introduction of the Bank of Canada's 2% inflation target in 1991, inflation has hovered around the 2% target and bond yields declined steadily - tracking inflation. By 1998, long Canada yields fell below 6%, where they have remained ever since. The post-1998 period is more representative of our current monetary regime than previous periods, and during this period long-term Canada bond yields averaged 4.14%, with inflation averaging exactly 2.00%. Not only have long-term Canada yields not exceeded 6% since 1998, they have not exceeded 4.5% since 2005. Therefore, Dr. Cleary concludes by noting that while today's bond yields of 2% are indeed abnormally low, there is no reason to expect they will increase beyond 4% in the intermediate term, or above 5% in the long term.