Q. Evidence of Ms. McShane, Equity risk premium tests, Pages 44-56: Please confirm that the average of any estimate always changes when for some reason you exclude a large number of observations (discussion page 52) and that currently the loose monetary policy in the US has a lot of inflation hawks worried about incipient inflation in the US.

A. It is confirmed that the estimated average of any series of numbers will change when observations which differ from the average are removed. As stated at page 52, line 1311, with reference to inflation and equity returns in Canada, seven of 88 observations were removed representing years in which inflation exceeded 10%.

The April 2012 Bank of Canada *Monetary Policy Report* states that "after moderating this quarter, total CPI inflation is expected, along with core inflation, to be around 2 per cent over the balance of the projection horizon" (2014). Further, in late 2011, the Government and the Bank of Canada renewed Canada's inflation-control target for the period to December 31, 2016 at the midpoint of the control range of 1% to 3%. There is no evidence that inflation is expected to be close to 10% in the foreseeable future. The April 2012 Consensus Economics *Consensus Forecasts* anticipates CPI inflation in Canada to average 2.0% through 2022.

In the United States, at its January 2012 meeting, the Federal Reserve Open Market Committee (FOMC) named an explicit, numerical inflation target for the U.S. of 2%. Although U.S. monetary policy has for many years focused on the dual mandate of maximum employment and price stability, this was the first time that an explicit inflation target has been specified. As stated by James Bullard, President and CEO of the Federal Reserve Bank of St. Louis following the announcement,

> Flexible inflation targeting enables central banks to conduct a stabilization program and make it as effective as it can be made without departing from the longer-run goal of keeping inflation low and stable. This reflects a conventional wisdom borne of the 1970s, namely, that allowing inflation to rise and accelerate not only is not helpful for the macroeconomy, but is actually very damaging. During the 1970s, U.S. inflation eventually rose to double-digit levels, and this was accompanied by especially poor macroeconomic performance on the real side of the economy. The lesson for U.S. policymakers and many others around the world has been that high inflation just causes problems and does nothing to help address fundamental macroeconomic issues.

By definition, an "inflation hawk" refers to an individual concerned with the risk that inflation poses to the economy. While there are "inflation hawks" who are concerned about incipient inflation, the most recent long-term *Consensus Forecasts* anticipates CPI inflation in the U.S. to average 2.3% through 2022.