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EVIDENCE

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on

FINANCE

Chair: Jim Peterson

Meeting No. 134

Friday, May 5, 1995

ORDER OF THE DAY:

Briefing on the Bank of Canada's report on monetary policy

WITNESSES:

Bank of Canada: Gordon G. Thiessen, Governor; Charles Freedman, Deputy Governor; Tim Noel, DeputyGovernor.

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EVIDENCE

[*Recorded by Electronic Apparatus*]

Friday, May 5, 1995

.0934

[*English*]

The Chair: We have an official quorum. We can now commence. Appearing before us today is Bank of Canada Governor Gordon Thiessen and Deputy Governors Charles Freedman and Tim Noël.

Welcome, Mr. Thiessen. We're very pleased to have you with us.

Mr. Gordon Thiessen (Governor, Bank of Canada): Thank you, Mr. Chairman. It's a great pleasure for me and my colleagues to be here. I certainly welcome this opportunity to appear before this committee. Your invitation provides me with an opportunity to introduce to you our new ``Monetary Policy Report", which we issued a couple of days ago.

.0935

[*Translation*]

But before I tell you about this report, I would just like to give you a brief explanation of the reason why we felt it was necessary. For some time, we have been seeking ways within the Bank to improve communications. As a result, we changed the look of our recently published annual report in order to provide more information about our many responsibilities and reach a broader public.

[*English*]

The objective of this new ``Monetary Policy Report" is to provide more information on our conduct of monetary policy. By separating our detailed commentary on monetary policy from our annual report, we can be more timely and we can discuss monetary policy issues in greater depth. That should allow us to be more forward-looking in our commentary.

We are going to be issuing this report twice a year, in May and November, and we are hoping it will contribute to an increased dialogue on monetary policy issues in Canada. If I may say so, Mr. Chairman, my colleagues and I would be absolutely delighted if you and your committee were interested in inviting us back to your committee on a regular basis to discuss with you each new issue of this report as it comes out.

The Chair: I think you can take it for granted, Governor, that you will have an invitation for every one of these reports, and we welcome it. Thank you.

Mr. Thiessen: Thank you very much, Mr. Chairman.

I'll now move on, rather briefly, to the contents of this report.

[*Translation*]

We point out in this report that the purpose of Canada's monetary policy is to contribute to economic stability by preventing inflation from undermining the value of our currency. By controlling inflation, we can improve productivity and avoid major fluctuations in economic activity.

[*English*]

The bank is committed to achieving specific inflation control targets along a path to price stability. Since early 1993, core inflation, as we measure it, has consistently been within the bank's target bands. Judgments about what policy action should be taken to achieve these targets require regular reconsideration. This involves an assessment of the factors affecting inflation, especially the strength of aggregate demand - the strength of total spending relative to the production capacity of the economy.

[*Translation*]

In 1994, exports drove economic growth in Canada, which, at a level of 5.6%, was far stronger than predicted. Despite a high rate of growth, the economy was still showing an ability to grow even further in early 1995.

[*English*]

During 1994 the depreciation of the dollar and the resulting high import prices have been a source of upward pressure on prices, as has been the sharp rise in world commodity prices. However, there have been other factors working to contain total costs and aggregate prices. Let me give you some examples.

Wage pressures have been moderate and productivity has increased. The result has been lower unit labour costs of production, declining unit labour costs of production. We've also seen increased competition in the retail and manufacturing sectors, and that has also resulted in downward pressure on prices. In addition, aggregate price inflation has been restrained by lower costs for machinery and equipment, particularly because of falling computer prices.

[*Translation*]

As for the future, Canada's economic prospects remain favourable. It is true that economic growth in the US is starting to slow, but it is likely to attain a level of growth that can be more easily sustained. And the international context continues to be generally encouraging as far as Canada is concerned.

.0940

[*English*]

It is true that some of the recent statistics have indicated that domestic demand in Canada is likely being held back by the rise in interest rates over the past year and by government restraint. Nonetheless, we at the Bank of Canada still expect the economy to continue to expand and to take up slack during 1995, but at a more moderate pace than the unsustainable rate of last year. So while the amount of excess capacity in the economy should decline further, it will still be a source of downward pressure on inflation in 1995.

[*Translation*]

At the same time, it is possible that the full impact on prices of past depreciation of our exchange rate has not yet been felt in the economy, and this could cause a temporary rise in the inflation rate. However, the recent strengthening of the dollar should start to counteract that.

[*English*]

As for the other evidence, recent surveys put inflation expectations within the bank's target band, and the monetary aggregates we look at very closely also support an outlook of low inflation.

When all of these factors are considered, when we put all of the evidence together, the current outlook for inflation is in line with the bank's inflation control targets. In other words, we are currently satisfied with how the inflation control process is going.

However, I have a caution. This is the point in the economic cycle when particular caution needs to be exercised by the bank and we will be monitoring the situation closely.

To close, let me remind you that low inflation is a crucial ingredient for sustainable economic expansion. Thank you, Mr. Chairman.

The Chair: Thank you, Governor.

[*Translation*]

Mr. Pomerleau.

Mr. Pomerleau (Anjou - Rivière-des-Prairies): Some economists are suggesting that the US economy could slow considerably in 1997, which would obviously have serious consequences for Canada. What do you make of those predictions?

Mr. Thiessen: Well, I do not know. At this point, there is a lot of talk of a soft landing in the US, rather than a marked economic slowdown. Current indicators and statistics all suggest that the US economic growth rate is slowing, but not dramatically. We are really not seeing much of a change. I see no reason why there would be a dramatic slowdown there. Current statistics all indicate that there will be no recession in the United States, at least not for the time being.

[*English*]

Mr. Grubel (Capilano - Howe Sound): I hope I'll have the opportunity to ask three short questions, but first I'd like to make a comment, and that is to congratulate you on preparing this report. I think it's a wonderful initiative and I appreciate it very much. I think members of Parliament and the finance committee will too, especially your offer to come back periodically.

I am especially pleased about the unit labour costs and labour productivity statistics shown here. I know of a study in the United States that showed an extremely high correlation between the difference between labour income and productivity growth, which determines the rate of unemployment in the United States over long swings, including the 1930s and the post-war years and all of that. This is a very favourable development, although I wish next time you'd have a chart on which you also showed this relative to the U.S. in equal currencies, either in Canadian or U.S. dollars.

I have a question. So much emphasis in your talk is on very recent things. What has been the annualized rate of inflation, on a month-to-month basis, in the last four months?

Mr. Thiessen: I don't know if I have that in my head.

.0945