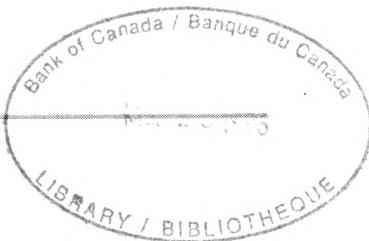


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R= 013342 I= 0061 C= 002 G= DATE: 960516 or of the Bank of Canada
before the House of Commons
Standing Committee on Finance
Wednesday, 15 May 1996

Opening Statement by

Gordon G. Thiessen

I am pleased to be invited to appear before this Committee to discuss our spring *Monetary Policy Report*, which was released last week.

In each *Monetary Policy Report* we present the Bank's assessment of the current trend of inflation and outline the monetary policy actions that we felt were necessary to keep that trend within the Bank's target range of 1 to 3 per cent for inflation control. The reports also provide the Bank's outlook for inflation in the near and medium term and give some insight into our analysis of economic indicators.

If I may, I would like to repeat what I have told you before about the operation of our inflation-control targets. As we note in the Report, these targets are not an end but the means by which the Bank contributes to the good performance of our economy. An economy functions better with low inflation. As well, by taking actions to hold inflation within our 1 to 3 per cent target range, monetary policy acts as an automatic stabilizer of the economy. When economic activity is strong and is pressing on the limits of capacity, with the risk of pushing inflation through the top of our range, the Bank will act to tighten monetary conditions. In exactly the same way, a weak economy that may result in the trend of inflation falling below our range will lead the Bank to ease monetary conditions.

Let me amplify why we believe it is important to keep the trend of inflation inside our target range. This is a commitment we have made to Canadians to provide them with a high degree of certainty about the general level of prices in the economy. Confidence in a stable value of money through tight inflation control makes it easier for Canadians to make plans and to take sound savings, investment and production decisions. Our responsibility is to act promptly if there is evidence that the

trend of inflation risks rising above or falling below our target range. Such prompt action minimizes near-term uncertainty about price movements and encourages expectations about the future trend of inflation that remain consistent with our target range.

Our measure of core inflation in the Consumer Price Index moved into the lower half of the target range in December of last year. At the same time, despite Canada's strong export performance in the second half of 1995, the overall pace of economic activity was slower than expected, to a significant extent because of weak consumer confidence. As a result, the margin of unused capacity widened and downward pressure on inflation continued.

In this climate, the Bank has reduced its operating band for overnight interest rates on six occasions since the end of October, easing monetary conditions by about 200 basis points, to the lowest level in two years. Financial markets responded positively to these actions. Money market rates declined broadly in line with the overnight rate, and there has been an underlying firmness in the Canadian dollar. This improved sentiment in financial markets has reflected Canada's good inflation performance, progress in achieving budget deficit reductions, and the sharp improvement in our external trade and payments position in the second half of 1995.

The Bank has taken a measured approach in its actions, in order to foster as much understanding of these improved economic conditions and as little uncertainty about our intentions as possible.

The prospects for 1996 look promising. The U.S. economy, the most important element in Canada's external economic environment, appears to have returned to a path of steady growth. Domestic demand should also improve in the coming months, encouraged by the significant drop in short-term interest rates.

All told, external and domestic factors suggest that economic activity will expand faster in 1996 than in 1995. Nonetheless, it is unlikely that slack in the economy will be taken up in any significant way before the end of the year. Thus, we expect that our core measure of inflation will remain in the lower half of our target range through 1996.

However, monetary policy must be forward-looking, and as we look to the medium term, there are a number of uncertainties about how the Canadian economy will unfold.

While the expected pickup in economic activity should take up some of the slack in the economy through 1997, it might still leave significant unused capacity in the economy. Such an outcome raises the possibility that a year or two from now the trend of inflation might fall below the lower limit of our target range. An easing in the desired medium-term path of monetary conditions would be implied to counter such a trend.

But we must also consider the possibility that the significant easing of monetary conditions over the past six months may lead to a pronounced turnaround in consumer confidence. Such a reversal of confidence could result in a much stronger economic upswing and less concern about downward pressure on the trend of inflation.

Thus, we will be examining the economic information carefully over the coming period in order to come to a judgement on the balance of risks regarding the trend of inflation.

We would now be pleased to take your questions.