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BANK OF CANADA.

SPEECHES: GOVERNOR.

Senate of Canada

Proceedings of the Standing Senate Committee on Banking, Trade and Commerce

Second Session, Thirty-fifth Parliament, 1996

Chairman:
The Honourable MICHAEL KIRBY

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Tuesday, March 19, 1996
Tuesday, March 26, 1996

Issue No. 1

Organization meeting and First Proceedings on:
Examination of the present state of the financial system in Canada.

INCLUDING:
THE FIRST REPORT OF THE COMMITTEE

WITNESSES:

From the Bank of Canada:

Mr. Gordon Thiessen, Governor; and

Mr. W. Paul Jenkins, Deputy Governor.

MEMBERS OF THE COMMITTEE

The Honourable Michael Kirby, Chairman

The Honourable W. David Angus, Deputy Chairman

and

The Honourable Senators:

Austin, P.C., *Fairbairn, P.C. (or Graham), Hervieux-Payette, P.C. Kelleher, P.C. Kenny, Kolber, *Lynch-Staunton (or Berntson), Meighen, Perrault, P.C., St. Germain, Simard, Stewart

* Ex Officio Members

(Quorum 4)

Proceedings of the Standing Senate Committee on Banking, Trade and Commerce

Issue 1 - Evidence

Ottawa, Tuesday, March 26, 1996

The Standing Senate Committee on Banking, Trade and Commerce met this day, at 10:00 a.m., to continue its examination on the state of the financial system in Canada.

Senator Michael Kirby (Chairman) in the Chair.

The Chairman: Senators, this is our annual meeting with the Governor of the Bank of Canada to talk about macro-economic policy. As usual, we have scheduled this meeting to follow the budget.

Governor, we appreciate you taking the time to be with us this morning. Since this is our third annual meeting with you, you are used to the format in which you begin with an opening statement and we then have a policy discussion on a variety of topics that I know the senators wish to raise with you. For the record, perhaps you would introduce your colleague Mr. Jenkins.

Mr. Gordon G. Thiessen, Governor, Bank of Canada: Thank you very much, Mr. Chairman. My colleague is Paul Jenkins, Deputy Governor in charge of economic analysis at the Bank of Canada.

We are pleased to appear before you again this year to explain the Bank of Canada's monetary policy and to give you our assessment of current economic and financial conditions. The recent release of our annual report provides a good occasion for us to present an account of our management of monetary policy.

[Translation]

Let me begin with our monetary policy objectives. The agreement between the Government of Canada and the Bank of Canada is to hold inflation within a target range of 1per cent to 3 per cent from the end of 1995 through to the end of 1998. By then, the government and the bank are committed to deciding on a future target range that will be consistent with price stability.

[English]

I cannot emphasize too often, senators, that price stability is a means to an end, not an end in itself. Price stability is the appropriate objective for monetary policy because it contributes to a more productive and a more stable Canadian economy.

As we point out in our report, the bank has once again met its inflation-control target. Following four years of good inflation performance, Canada is, I believe, establishing a reputation as a low-inflation country. This reputation has been helpful as we have had to cope with fluctuations in international financial markets, concerns about the budgetary situation in Canada, and uncertainty which surrounded the Quebec referendum campaign.

[Translation]

In judging inflation performance, it is important to focus on the underlying trend rather than on the month-to-month fluctuations in the Consumer Price Index. We use the year-over-year change in the CPI, excluding the volatile food and energy components and indirect tax effects, as an indicator of the trend. This measure of inflation declined through the second half of 1995 and, at 1.6 per cent, is now in the lower half of our target range.

[English]

The inflation-control targets for monetary policy operate as a kind of built-in stabilizer for the economy. When the economy is expanding at an unsustainable pace which will lead to price pressures which are then likely to push inflation through the upper limit of our range, the bank will act to tighten monetary conditions in order to slow the pace of economic activity and ease price pressures. Similarly, a weak economy that implies a downward trend of inflation with a risk of going below the lower limit of our range will lead the bank to ease monetary conditions in order to stimulate economic activity.

In line with this approach, the bank has been acting since the autumn to lower short-term interest rates in Canada. Our most recent action took place last week when we lowered the bank rate and our operating band for the overnight rate <#00BC> of one percentage point. The bank rate is now 5 <#00BC> per cent, and the operating band for the overnight rate is now 4 <#00BE> per cent to 5 <#00BC> per cent.

The Canadian economy struggled through much of 1995 as the U.S. economy slowed, and Canadians had to cope with the sharp rise in interest rates early in the year following the Mexican currency crisis and market nervousness about the Canadian fiscal situation. Prospects for 1996, I believe, look more promising. The U.S. economy appears to us to be on a sustainable, low-inflation growth path, and easier monetary conditions in Canada are providing substantial support for economic activity here.

[Translation]

However, economic confidence among Canadian households remains weak. The recent rise in mortgage rates will not have helped. That rise reflected pressures on our bond yields coming from U.S. financial markets, following some strong economic data in that country. External shocks like that are bound to hit us from time to time. This time, however, the response in Canada was more muted then we have seen in the recent past - the Canadian dollar remained firm, differentials between longer-term U.S. and Canadian bond yields tended to narrow, and money market conditions stayed favourable for the move by the Bank of Canada to lower short-term rates.

[English]

I believe that the improvement in our fiscal situation over the last several years and our low inflation record are important factors contributing to this greater stability in financial markets, and I hope that we will see a further narrowing of the medium- and long-term interest rate differentials between Canada and the United States through the year.

The Canadian export sector has performed well, and I believe it should continue to do so. This is reflected in the encouraging recent increases in employment. Better employment prospects and more stable financial markets should, together, be helpful for household confidence and for a recovery in the housing market and consumer spending during the coming year.

[Translation]

I should also draw your attention to the information in the annual report on the bank's other activities. Like many other public sector institutions, the bank has undertaken a major reassessment of its operations and is implementing initiatives aimed at improving the effectiveness of its operations and lowering costs.

[English]

Mr. Chairman, that ends my statement. My colleague and I would be happy to answer your questions.