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BANK OF CANADA

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Notes for remarks by
Gordon G. Thiessen
Governor of the Bank of Canada

to the

Metropolitan Halifax Chamber of Commerce
Halifax, Nova Scotia
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I want to thank the Metropolitan Halifax Chamber of Commerce for the invitation to speak to you today. I was particularly pleased to be invited because it gives me an opportunity to announce that the Bank of Canada is in the process of setting up its new representative office for the Atlantic Region in Halifax. This office is part of a larger program which includes a new office in Calgary for the Prairie Region and an expansion of our existing offices in Vancouver, Toronto, and Montreal.

Experience has taught us that both the economy and monetary policy work better when people in all parts of Canada are well-informed about the major economic issues of the day and about the orientation of monetary policy. That is why in the last few years, the Bank has been making systematic efforts to increase public awareness and understanding of these matters, by providing more information on the economic climate and by explaining what we are up to and why. We have been doing this through a variety of means -- regular reports on monetary policy, published extracts from our Board meetings, press releases, technical reports, speeches like this one, and so on.

Of course, to do our job well, we at the Bank also need to be well-informed about what is happening in the economy, from one end of this country to the other, and to listen to the views and concerns of Canadians about the economy and monetary policy.

These new and expanded representative offices are designed to improve the contacts between the Bank and Canadians from all regions of the country. They should help increase the Bank's information and understanding of economic developments in each region. The Bank has always kept in touch with the regions and followed closely all the available regional economic data. What we are seeking to improve is our ability to interpret these data. That requires enhanced contacts with businesses, governments, associations, and economic analysts in each region.

Our representatives in Halifax will be covering the entire Atlantic Region for us. With your help and the help of those members of the Bank's Board of Directors from the Atlantic Provinces, they will be seeking to establish a wide range of contacts.

I should also mention to you the regular provincial outreach visits that the Bank has been undertaking over the past number of years. These visits involve one of the Bank's Senior Management and the member of our Board of Directors from the province concerned. During the visit, we meet with various business and other groups, provincial governments, as well as the media. We also make presentations and answer questions on the Bank's policy at a public forum and before a university or college audience. Our regional representatives will now also participate in these outreach activities and help organize them.

So far, I have been speaking only of contacts on the economy and monetary policy, but our representative offices will also have a broader public communications role covering all aspects of the Bank of Canada's responsibilities. This will include, for example, the increased effort we need to make to ensure that Canadians are aware of the anti-counterfeiting features in our bank notes. A well-informed public is an important deterrent to counterfeiting.

Our office here in Halifax will also have an operational responsibility to oversee the new arrangements we are putting in place for the distribution of bank notes to financial institutions. With those arrangements, bank notes will be moving directly from financial institutions with surpluses of notes to those with requirements, and the notes will typically only go back to the Bank of Canada to be destroyed when they are no longer fit for reissue. Our regional offices will be helping to monitor the new arrangements to ensure that they work efficiently and that the currency system continues to provide good service to Canadians.

Let me now introduce to you the Bank of Canada's two senior representatives for the Atlantic Region -- Paul Fenton, Economics Representative and Robert Dolomont, Operations Representative. I hope you will welcome them when they come calling. And please do not hesitate to contact them to obtain information, to express your point of view, or to get in touch with those of us in Ottawa.

As I said earlier, it is important for Canadians to be well-informed about the economy and monetary policy. And I welcome the public attention that economic issues receive these days. There are three questions in particular, related to monetary policy, that I hear frequently and that I would like to discuss with you today.

First, some people wonder why the Bank is still so intent on controlling inflation when it is so low and no longer seems to be a threat. Is it possible that, with this continued focus on inflation, monetary policy will fail to provide the support necessary for incomes and employment to grow?

Second, if low inflation is good for the economy, why have we not seen more of its benefits in the performance of our economy?

Third, the Bank has taken a rather positive view about the likely pickup in the economy this year and next. How does that square with a situation in which economic confidence has been undermined by the difficulties our economy has gone through over the past number of years?

1. Why the ongoing focus on inflation control?

Inflation in Canada has averaged less than two per cent a year over the last five years. So why does the Bank of Canada remain so focussed on its target range for inflation control? Why not put more emphasis on economic growth and employment?

The reason is that a commitment to low inflation is the best way for monetary policy to contribute over time to a well-performing economy -- one that delivers economic growth and employment. Why? Because such a commitment gives Canadians confidence that the value of their savings will not be eroded by inflation. This is the key to maintaining a low interest rate climate. Low inflation also generally reduces uncertainty about the future and allows people to make better economic decisions. High inflation, by contrast, tends to increase economic inefficiency by making prices difficult to interpret and encouraging speculative activities rather than productive investments. We know from past experience that this only leads to painful cycles of economic boom and bust, and not to a stable economy.

Let me also respond to the concern that the ongoing focus on inflation control may conflict with the achievement of full economic recovery and job creation. In fact, when the Bank takes actions to keep inflation inside its current target range of 1 to 3 per cent, monetary policy operates as an important stabilizer for the economy, helping to maintain sustainable growth over time in output and employment.

For example, when the economy is expanding at an unsustainable pace and pressing on the limits of production capacity, thereby threatening to push the trend of inflation through the top of the target range, the Bank will tighten monetary conditions to cool things off. But the Bank will respond with equal concern, by easing monetary conditions, when the economy is sluggish and there is a risk that the trend of inflation will fall below the target range. And that is what we did from late 1995 through to late 1996.

Of course, we cannot "fine-tune" the economy since it takes time for the effects of monetary actions to work their way through. But what this approach to policy provides is monetary support which, over time, will help output and employment expand at their potential. Thus, by focussing on inflation, the Bank is also doing the right thing for the economy.

For all these reasons, I believe that the Bank must remain committed to its inflation-control targets. While the targets were introduced to help reduce a high inflation rate, they continue to be the best means to conduct monetary policy now that inflation is low and the aim is to keep it low.

2. Where are the benefits of low inflation?

With all the favourable news on the inflation side over the past five years, why have we not managed a better economic performance?

I believe that the explanation lies in the magnitude and complexity of the transformation that our economy has had to undergo in the last few years. And clearly we are not finished yet. This transformation has been in response to two major challenges. First, the global challenge, stemming from rapid technological advancements and increasingly open and competitive world markets. Second, the domestic challenge, arising from the need to reverse the economic imbalances and excesses that occurred during the 1970s and 1980s. I am referring here to rising costs of production in that period, speculative activity (especially in the real estate sector), large fiscal deficits and rising debts, particularly by Canadian governments.

The restructuring process has been difficult and stressful. It has meant layoffs, both in the private and, more recently, the public sectors, and a great deal of uncertainty. Moreover, in 1994 and early 1995, investor nervousness about our fiscal position and uncertain political situation led to temporary sharp increases in interest rates in the wake of global financial market turbulence. All of this left Canadians worried about the future and cautious about spending. In these circumstances, the benefits of low inflation have been slow to be felt, and the recovery from the recession of the early 1990s has been more gradual than expected.

There is no getting around the short-run costs to Canadians of these difficult, yet absolutely necessary, structural adjustments. And it is easy to lose sight of the important, longer-term improvements that have been taking place in our economy. Indeed, over the last few years, there has been a remarkable economic transformation in this country.

I have already mentioned our greatly improved inflation performance. The decline in inflation from the high levels of the 1970s and 1980s has contributed to lower interest rates, a more stable economic environment, and more effective cost control by businesses.

Canadian firms have also been investing in new technology and streamlining their operations to become more productive and efficient. With this, and a more outward-looking attitude, they have been able to benefit from a favourable exchange rate to break into new world markets and expand their market share.

Adjustment efforts in the public sector have also been successful. Deficits have been reduced, and governments have been moving towards less vulnerable debt positions. The ratio of government debt outstanding relative to the size of our economy -- which is what investors really care about -- has started to fall this year and should continue to do so. A decline in this ratio is essential to restore fully our financial health.

But that is not all. With our success in exporting and the reduced borrowing needs of Canadian governments, the persistent deficit in the current account of our international balance of payments has been sharply reduced. This means that, as a nation, we are no longer rapidly building up our indebtedness to foreigners.

Like the rest of Canada, the Atlantic Region knows only too well the difficulties involved in adjusting to the new economic realities. We are all aware of your efforts here in Nova Scotia to diversify your economic base and of your progress in dealing with the fiscal deficit. Many people will have heard of the Sable Island gas project and of the new Stora paper plant, the first of its kind in North America to produce super-calendared paper. But I understand that there are also a number of other developments on the go to change and broaden the economy of Nova Scotia. Restructuring is never easy. However, I am sure that the adjustments you are making will provide the base for a better economic future in this province.

3. Why is the Bank optimistic about an economic pickup?

There is no doubt that the difficulties associated with the economic transformation taking place in Canada have acted as a drag on output and employment. But I believe we have reached the stage where the benefits from these necessary adjustments have begun to outweigh the difficulties.

One of the major benefits has been a marked decline in domestic interest rates since late 1995. As a result, many interest rates in Canada are now at their lowest levels since the 1960s. And for maturities of less than 10 years, they are appreciably lower than comparable U.S. rates.

These interest rates represent a substantial stimulus to domestic spending in our economy. However, because of the considerable lags between monetary policy actions and their impact on the economy -- 12 to 18 months -- it is only quite recently that signs of the response to those lower interest rates have become apparent. These lags explain some of the gloom during the past year regarding our economic prospects.

Recent evidence, particularly from the interest-sensitive sectors of the economy, is very encouraging. As the economic results for the second half of 1996 show, and the monthly data so far for 1997 confirm, there have been substantial increases in spending on housing, motor vehicles, and consumer durables, just as expected. As well, businesses continue to increase their capital spending. And, after a slow start to the year, growth in private sector employment has resumed, offsetting cutbacks and layoffs in the public sector. Since the beginning of 1996, the private sector has generated some 275,000 net new jobs, six times as many as were lost in the public sector.

Because of the lags involved, the substantial past easing of interest rates should continue to support robust growth in domestic spending for some time. And with our exports continuing to benefit from strong U.S. demand, the Bank is looking for solid economic expansion and further employment gains through the year.

Because we still have a fairly wide margin of spare production capacity in this country, our economy has ample room for strong growth in coming quarters, without a resurgence of inflation. However, as that excess capacity is absorbed, less monetary stimulus will be needed to keep the Canadian economy on a non-inflationary growth path. It is by maintaining Canada's low trend of inflation that monetary policy will contribute to the type of durable expansion in our economy that delivers improved income and employment prospects for Canadians.

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In conclusion, let me just say that Canada has been through a very difficult period of major economic adjustments, some of which are still ongoing. But we have also made huge strides in restoring the credibility of our economic policies and implementing changes to lay the foundation for a more efficient, prosperous economy in the future.

Things are already looking up. And I believe more of the benefits of our transformed economy are on the way.