BANK OF CANADA

Opening Statement b
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Governor of the Bank of Canada
before the Standing Senate Committee on
Banking, Trade and Commerce
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This regular appearance before your Committee, following the release of the Bank of Canada's Annual Report, gives my colleagues and me an opportunity to present an account of our stewardship. As in previous years, I will focus particularly on monetary policy, but I will also say a few words about our other activities.

As you know, our monetary policy objective is to hold inflation in Canada within a target range of 1 to 3 per cent. Once again this past year, we met that objective. Looking through movements in the volatile elements of the Consumer Price Index, the trend of inflation remained in the bottom half of our range.

I know there are those who believe that the Bank should set aside this focus on keeping inflation low and somehow redirect its actions to economic growth and employment. In fact, our inflation-control targets provide the best assurance that monetary policy will contribute to long-run growth and will also act as an important economic stabilizer over shorter periods to help guide the economy to a path of full capacity use and high employment.

Let me explain what I mean. A monetary policy that delivers low inflation provides more certainty about price movements and, therefore, a better climate for decision-making by businesses and households. A low inflation environment also avoids inflationary booms and busts, eliminates the distortions caused by the interaction of inflation and the tax system and prevents the misallocation of resources as people seek to profit or protect themselves from inflation. All these benefits contribute to a more efficient, productive and growing economy over the long term.

Over shorter periods, a monetary policy that seeks to hold inflation within our target range will be helping the economy to operate close to its full potential. Such a policy approach also ensures that the Bank will not make persistent misjudgments about how rapidly the economy is capable of growing over time.

Inflation-control targets have these advantages because the trend of inflation is the best indicator of how the economy has been performing relative to its potential. When excessive spending in the economy has been pressing against capacity limits, inflation will tend to rise. Similarly, a margin of unused economic capacity will put downward pressure on inflation. Inflation-control targets are, therefore, useful in signalling the need for monetary policy action when the trend of inflation looks like it will go through the bottom or above the top of the range.

As we point out in our Annual Report, the economy has been going through a major, but necessary, transformation in both the public and private sectors. The magnitude of the adjustments taking place and their associated effect on consumer confidence have held back the expansion of economic activity.

In these circumstances, the performance of the Canadian economy over the past couple of years has been disappointing but not surprising. Persistent slack in the economy and downward pressure on inflation towards the bottom of our target range have called for an easing of monetary conditions. Unfortunately, concerns about the budgetary positions of Canadian governments, interacting with the worries caused by the Mexican currency crisis and by the Quebec referendum, restricted the Bank's room for manoeuvre through much of 1995.

However, since November 1995, the Bank has taken actions to ease monetary conditions substantially. As a result, short-term interest rates are at their lowest levels since the 1960s. And the improved budgetary positions of governments in Canada have contributed to declines in medium- and longer-term interest rates. Indeed, rates in Canada are below those in the United States out to maturities of 10 years.

Given normal lags of 12 to 18 months, these lower interest rates are now having a considerable effect on interest-sensitive expenditures in the economy -- an effect that should continue through 1997 and into next year.

The prospects are good for reducing much of the present slack in our economy over the course of 1997 and 1998 and for a substantial improvement in the employment situation.

I would also like to draw your attention to the discussion in the Annual Report of our other activities. Major changes have been taking place in all areas of the Bank of Canada. We have found more efficient ways of carrying out our business, including new partnerships with the private sector. When all the changes are fully in place next year, they are expected to result in savings amounting to 20% of operating expenses.

Finally, let me point out changes taking place in the Bank of Canada's presence across Canada. We are establishing two new representative offices and upgrading existing ones to improve communications between the Bank and Canadians in every part of the country.