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Luncheon Address by
John W. Crow
Governor of the Bank of Canada
on the occasion of a
Meeting of the Board of Directors
of the Bank of Canada
in Halifax, Nova Scotia
June 30th, 1987

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The Board of Directors of the Bank of Canada has for some time now met once a year in a city other than Ottawa. This practice has proven extremely valuable. It gives Board members as well as the senior management of the Bank an opportunity to experience directly what is going on in various parts of the country. It also provides the occasion to discuss regional issues with the people who are most knowledgeable about them. Eight years have passed since the Board last met in Halifax, and it is a pleasure to be back.

The goal of monetary policy, the Bank of Canada's primary concern and responsibility, is to help achieve and maintain good economic performance in Canada. And today I want to focus my remarks on how the Canadian economy has been doing, as well as on the prospects and uncertainties it faces.

We all know that what matters most in our general economic performance is how well we can do in generating worthwhile jobs for our expanding work force. We all want an economy in which Canadians from all regions of the country can prosper and enjoy rising living standards. More contentious questions arise regarding what kinds and what settings of policies will best serve these broad aims. The best contribution monetary policy can make is to pursue a course that will allow us to reap the benefits of stable prices.

Good monetary policy cannot guarantee economic prosperity -- a number of other things have to go right and be done right as well. But we are not likely to get very far in reaching our economic goals if Canadians do not feel confident about the value of the money they use. A look at the experience of other countries and at our own recent economic history will readily confirm that this is true. So in my commentary on the Canadian economy, let me begin with a review of what has happened with respect to the value of money -- in other words, to inflation.

It is very gratifying to see how much the situation has improved over the past few years. It is all too easy to forget that back in 1981, when inflation was in double digits and rising, quite a few Canadians believed, and were acting on the belief, that inflation would beat us -- that it would never be controlled. Yet, by whatever yardstick, inflation in Canada has come down a very long way since then. For example, the annual rate of increase in the Consumer Price Index has dropped from a 1981 peak approaching 13 per cent to under 5 per cent.

With the degree of success that has been achieved to date in reducing inflation in Canada, we have been able to bring our interest rates down substantially. Short-term interest rates -- which, if anyone needs reminding, reached levels in excess of 20 per cent at the peak of inflation in

1981 -- have fallen to less than 8 1/2 per cent. There has been a comparable drop in mortgage rates. This has been the foundation for the uninterrupted growth the Canadian economy has enjoyed since the recession of 1981-82.

Let me recall for you briefly what the Canadian economy has managed to achieve over the past four years or so -- one of the longer periods of sustained economic expansion in our history. We have had substantial gains not only in total output, but also in employment. Total output in Canada grew by over 18 per cent between the low point of the recession, at the end of 1982, and the end of last year. Over that same period, the number of Canadians employed rose by more than a million -- an increase of over 11 per cent. These gains have been accompanied by and, indeed, spurred by a substantial increase in spending by Canadian consumers. Housing construction, for example, was over 50 per cent higher at the end of 1986 than four years earlier, and purchases of new automobiles were up by more than 40 per cent. An added boost was provided by exports, which increased by more than 40 per cent in volume. By the end of 1986 all of these measures of activity in our economy were well above their pre-recession peaks. I might add that since 1982 the Canadian economy has generally grown faster than any of the other major industrial countries.

But as we are all aware, not all Canadians have shared equally in the growth of the economy. The good overall gains in output and employment since the recession mask sharp disparities in the extent of economic recovery in different regions and sectors of the Canadian economy. While unemployment in Central Canada is almost back to pre-recession levels, in the West and here in Atlantic Canada unemployment has been disappointingly slow to come down.

The main origins of these regional imbalances are not difficult to identify. In particular, weak prices in international markets for a number of our resource exports have had a very negative impact on certain regions of the country, and especially on business investment, overshadowing the positive contribution of other factors affecting the Canadian economy. In the case of the Nova Scotia economy, the slide in world oil prices hit offshore exploration and development very hard. And, of course, the weakness in this sector has spilled over into the construction and service industries associated with it. The setbacks in these industries have offset the strong performance registered over the past year or so in the lumber, pulp and paper and fishing sectors. Other regions of the country, and Western Canada in particular, have been similarly hard hit by weak world prices for some of their principal products such as oil, grains and potash.

Clearly, some improvement in the prices of key resource products could go a very long way towards improving the economic fortunes of a number of parts of the country. So I regard recent increases in the prices for some primary commodities as being helpful -- they were too low relative to production costs in Canada. Others are still too low. But in welcoming or looking forward to a recovery in the prices of various products that we produce, we have to watch out for and prevent a faster rise in other prices as well. A resurgence of general inflation would only hurt us all and would not reduce disparities in the economic performance of Canada's different regions.

The kind of situation I have just described, of major differences in economic conditions among different regions and provinces, has been a persistent fact of Canadian economic life over the years. At present the differences are particularly pronounced. Canadians are also familiar with the efforts that have been made by public policy to mitigate those differences. These efforts have largely been focussed on tax and public spending arrangements of a regional character. The only point I want to make in regard to such arrangements is that while they are a long-standing and well-recognized use of budgetary policy, they do need to be fitted into the broad framework of budgetary deficit reduction and public debt containment that is essential to financial stability and durable economic progress in this country.

What about monetary policy in this regard? At the Bank of Canada we are aware that questions are posed from time to time as to whether monetary policy could be conducted with more regional differentiation. Indeed, I recall delivering an address on this subject at the Ninth Atlantic Economic Conference at Acadia University in Wolfville some seven years ago. The essential point, true then and true now, is that financial links across Canada are so effective, so strong, that it is simply beyond the powers of monetary policy to impose different sets of financial conditions in different regions of the country. With the choices available nowadays as to where to borrow and where to save and invest, different levels of interest rates for savers and borrowers in different parts of the country are simply not sustainable. In consequence, the only way monetary policy can realistically be conducted is from a single national perspective. That is to say, although monetary policy cannot be tempered between one region and another, in deciding monetary policy we do take into consideration the circumstances and prospects of all the different regions and sectors of the economy since we are looking at economic performance across Canada all the time.

With that review of our performance over the past few years, I want to make some comments on the current situation in the Canadian economy and the prospects.

The latest statistics show that the Canadian economy is continuing to expand. Indeed, the current year is off to a very strong start. In the first quarter of 1987 the economy grew at a rate of more than 5 per cent, and what statistics we have at the moment point to further gains in the second quarter. Output growth has been fairly broad-based, but industries such as manufacturing and housing construction, as well as forestry and fishing, have shown particular strength. Alongside this strong expansion in production, and reinforcing it, has been a substantial pick-up in employment. And the vast majority of these new jobs have been full-time rather than part-time. Moreover, recent survey data suggest that business investment will increase in the months ahead.

However, there are some concerns, both international and domestic, which affect our prospects.

Serious and persistent budgetary and international trade and payments imbalances exist in the world. These imbalances and their repercussions are threatening growth in the world economy, as has just been emphasized in recent reports by such authoritative international organizations as the Bank for International Settlements and the Organisation for Economic Co-operation and Development. One by-product of these international problems, rising protectionist sentiment, has already had a disruptive effect in Canada. And in these generally uncertain conditions, private capital flows have been extraordinarily skittish. Their impact has spilled over at times into our exchange and money markets. While the international outlook can by no means be described as heartening, I am glad that I can say that governments of the major industrial countries are taking an active and co-operative approach to dealing with these problems.

Inflation is another area where a note of caution is required. Our progress towards price stability has stalled. By some measures the rate of inflation has risen slightly over the past year. One can indeed argue that this has been more the product of transient factors than of any persistent, or self-sustaining, cause. For example, the Canadian dollar, along with the U.S. dollar, has declined through the last two years by over 30 per cent against the currencies of some of our major overseas trading partners such as Japan, Germany and the United Kingdom. While this has, in the first instance at least, helped to redress earlier distortions and improved our competitive position, it has also pushed up the prices of our imports from those countries. At home, domestic producers will naturally tend to take advantage of the rise in the prices of competing imports to raise their own prices. Alongside these exchange rate effects we have had a series of increases in indirect taxes and charges of various kinds by federal and provincial governments. These also have inevitably raised prices for the consumer.

It may be that inflation will be drawn back to a declining trend as the influence of the two factors I have just referred to wears off. There is some basis for such a view. Figures for the country as a whole indicate that increases in wage costs to date have stayed quite moderate. But all too often in the past, price increases, from whatever source, have led to pressures for offsetting wage and salary increases and contributed to a real worsening of our inflation performance. It is therefore disquieting to note that recent wage settlements in some sectors, including some parts of the public sector, have recently begun to pick up. There has been a more general buildup of price pressures in Central Canada, where production is closer to full stretch than elsewhere. Let me also emphasize that inflation in Canada is still running at a higher rate than in most other major industrial countries.

Preventing a deterioration of cost and price performance is clearly a priority for monetary policy. We will be alert to head off such a development because an inflationary process will damage both our competitive and productive position. We cannot afford to give up the hard-won ground we have gained against inflation. Further gains in restoring price stability are essential if we are to make the progress we all want to see on other economic fronts.

By way of conclusion let me say that Canada's recent overall economic performance has been better than we have seen for some time. To be sure, there is still a good deal of room for improvement, and there are some major uncertainties hanging over us. But if we continue to pursue steadily the goal of price stability and make progress in improving our productivity and ability to compete in international markets, we should be in a better position to cope with any difficulties that may arise in the international environment. We will also be better placed to take advantage of the situation as that environment improves.