Notes for remarks by
John W. Crow
Governor of the Bank of Canada

to the

Investment Dealers Association of Canada
75th Annual Meeting and Conference
Whistler, B.C.
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I doubt if I will bewitch markets today, but I do want to note that this is triply a very auspicious occasion. It marks three important milestones -- first, the 75th birthday of the Investment Dealers Association, alias, initially, the Bond Dealers Association and later, for a number of years interestingly enough, the Investment <u>Bankers</u> Association; second, the culmination of twenty years of distinguished service by Andrew Kniewasser as President of the IDA; and third, the handing over of the presidential torch to Charles Caty. To the IDA I say "Happy Birthday," to Andy "Well Done" and to Charlie "Good Luck!"

Over the years, and certainly in recent times, there has been a very close and collaborative relationship between the Bank of Canada and the IDA. The Bank has no formal regulatory mandate but it does have a profound interest in effective capital markets, for the transmission of monetary policy, in our role as lender of last resort, and as adviser and agent to the government on debt management.

In recent decades the Association has become a strong and uniquely national voice for the securities industry. This matters. The Association has developed a profile internationally as well as domestically. That matters also, and more than ever. Furthermore, it has evolved into an effective self-regulatory agency for a very large part of the industry and has presented a vigorous and reasoned view of regulatory and other public policy issues. Nor should one ignore the contribution it makes to the understanding of how capital markets work and what they contribute to economic growth.

These are also some of the reasons why I want to applaud the outstanding contribution that Andy Kniewasser has made to the Association and to this country. Andy had a long and distinguished career of public service before joining the Association and it is fair to say that he has continued in public service. For example, and this should not be underrated, he has always been ready to stand up for sensible financial policies, including sound money. May I say too, that Charles Caty has already made an important mark in your industry, particularly through his involvement with the Toronto Stock Exchange and the Canadian Depository for Securities. I have every confidence that he will increase his imprint through the work of the IDA.

The membership of the IDA constitutes a group that has a keen awareness of market realities and issues of confidence and credibility. You, for example, will readily appreciate that the days are gone, if they ever did exist, when borrowers could place their debt with few questions asked. In the context of an efficient global environment, there are lots of options as to where to invest, for Canadians and for others. Comfortable niches have all but disappeared. No borrower, public or private, can expect to have a captive market for its debt.

At the national level, this issue of confidence is often framed in terms of external debt -- the need to persuade foreigners to hold one's liabilities. The issue is more basic than that. Canadians themselves are by far the largest holders of Canadian debt. But they are not automatic holders either; they too have many alternatives if they are not confident that the financial assets they hold will retain their value.

Turning to the securities industry at large, I must recognize that recent times have not been good times. Indeed, the industry has experienced a more prolonged and pronounced recession than the country at large. The roots of the industry's problems are nonetheless similar to those of the economy in general -- a surge of demand which stretched markets and gave rise to behaviour and expectations that could not be sustained.

In the financial services industry, the cycle this time has been worldwide. This has served to take most of the glitter off so-called "globalization," at least for the time being. Fortunately, however, Canada has avoided many of the excesses that have afflicted others. Admittedly, household indebtedness in Canada did rise extremely rapidly in the 1980s. Still, leveraged buy-outs have not threatened corporate balance sheets in this country to the extent that has occurred in the United States. Nor have we had the wave of failures among financial service firms that has occurred there.

Still, there have been enough storm signals to bring prudential considerations to the fore. Because they have a special responsibility for the viability of the financial system, central bankers are bound to worry about these problems. This leads us to put a high premium on regulation that is effective and on clearing and settlement systems that are sound. So we tend to specialize in the awkward questions -- not about how arrangements work when everything goes right, but what happens when some things go wrong.

That is to say, we are particularly interested in questions of systemic risk.

The ballooning volumes of financial transactions in rapidly integrating markets around the world, the great complexity of many of the financial instruments and transactions that have been invented in recent years, and the almost instantaneous transmission of information and reactions from market to market on a global scale, have all served to heighten the risk of major accident. The sharp break on major stock markets in October 1987 certainly focussed the minds not only of the players but of regulators and others with prudential interests. After this scare, a number of adjustments were made to market practices. However, the initiative which has since attracted most widespread support and involvement is that of the Group of Thirty (or G-30 as it is commonly known).

This group's objective, as most of you know, is to put the major securities markets on a common basis that would feature a greatly shortened period for the settlement of trades, finality of payment, and the elimination of the movement of paper through the establishment of efficient securities depositories. This G-30 initiative is essentially a private sector undertaking, but it has the support of the authorities and a great deal of work is going on around the world, including in Canada, to realize these goals. Other initiatives have sprung up with respect to the netting of foreign exchange transactions. The Bank of Canada is very well plugged in to all these developments.

In the fixed income area, a great deal of effort has been devoted to establishing more efficient and fail-safe systems. Here, the Bank of Canada and the IDA have both had a direct involvement through their respective relationships with the Canadian Depository for Securities. The Bank has been working closely for a number of years with CDS in support of the latter's efforts to accommodate Government of Canada debt, first bonds and then treasury bills. At the same time, federal and provincial regulators have been working to satisfy themselves (and the Bank of Canada as well) that the various arrangements and systems currently in place within CDS, as well as those in the proposed Debt Clearing System, are appropriate. They need to meet the highest prudential standards and to satisfy other public policy considerations related to the distribution of risk within the system and access to the system. These public policy issues also apply to the proposed new large-value payment system and the foreign exchange netting scheme mentioned earlier. Given the complexity of the arrangements and the variety of interests involved, the process has moved more slowly than some had hoped. However, let me take this occasion to underline that it is extremely important for reasons of cost and risk minimization and international competitiveness to achieve a reliable and efficient clearing and settlement environment.

There are two related themes that I would like to dwell on for a moment. The first is the importance of the effective regulation of financial institutions and financial markets that I alluded to earlier. In the past few years we have undergone a process of refashioning the structure and regulation of the financial industry in this country, some aspects of which are still at the legislative stage. The securities industry was the first of the major financial groupings to feel the impact of these changes. The environment in which the industry must operate has been further affected by the prolonged slump in profitability and by jurisdictional tensions, which have tended to diminish the potential for consistent regulation. In these circumstances, the role that the IDA has played in self-regulation and as a national voice has added relevance.

Self-regulation does have the advantage too of flexibility and responsiveness to change. While the industry has experienced a great deal of change in recent years, the need for continuing adaptation is a reality of life. The pieces of the kaleidoscope have probably not all fallen into place yet. But whatever might be the arrangements for oversight, the regulatory framework must above all keep our capital market safe, fair and efficient.

The second point that I want to make is that inflation in the major economies, in addition to having adverse consequences in general, has had some significant implications for world financial markets and the securities business. On the one hand, the uncertainty associated with inflation contributed to greatly increased volatility in markets. That in turn both added to risk, and created new opportunities for trading and for developing all kinds of new products and techniques for hedging risk. On the other hand, inflation led to many excesses of speculation and debt and undermined the solid investment decisions that are the life blood of the securities industry and of economies.

The commitment of the Bank of Canada to bringing inflation under control and to moving towards price stability provides a solid foundation for the Canadian economy and for your industry. After all, your job, viewed from the perspective of the economy at large, is to channel savings into worthwhile investments. Those decisions will be a lot easier for everyone, and the outcome will be better, in an environment where price signals are meaningful.

In recent years, quite a lot rightly has been made of the importance of structural policies -- policies that are designed to improve the structure, flexibility and efficiency of the economy. This is a useful correction to a one-sided emphasis on the management of aggregate demand, involving broad fiscal and monetary policies. At the same time, it is increasingly realized that these broad policies also have a structural aspect to them. For example, fiscal policies can have an important structural dimension -- unfortunately not of a positive kind -- when they involve persistent large deficits and rapidly mounting debt loads.

On the other hand, monetary policy can make a structural contribution of critical importance by providing a framework of sound money for an economy that is based on money.

Some people understand very well what the Bank of Canada is getting at when we make this point. But quite a few clearly do not. I suspect that the point would rather quickly become painfully clear, if we were in fact to go in for a policy of unsound money. However, the Bank of Canada does not have the luxury of indulging in irresponsible behaviour in order to prove a point. Therefore we will continue to do what we can through explanation and reasoned argument, as for example we did extensively this year in our Annual Report for 1990 that was released in early March.

In other words, the Bank is committed to sound money. This commitment was given some specific parameters through the inflation reduction targets, that were announced in February. These targets envision a reduction in the year-over-year rate of increase in the Consumer Price Index to 3 per cent by the end of 1992, 2 ½ per cent by the middle of 1994 and 2 per cent by the end of 1995. And monetary policy will of course undertake the actions that are required to achieve this track. The more this is accepted and reflected in behaviour throughout the economy, the smoother the process of required adjustment will be.

In this regard, the Bank's present judgement is that we are no longer playing catch-up to the same degree as earlier with inflation and inflationary expectations. But while we believe that a momentum towards an easing of Canadian costs of production, and therefore of inflation, has been established, this still has to be clearly confirmed by the facts. That means that we shall be paying very close attention indeed to the way costs and prices develop in the next few months.

The purpose of pursuing price stability is of course to establish a solid foundation for sustained growth and prosperity in the economy. Because of the momentum I just noted, interest rates have come down a long way. And it is particularly gratifying to see them come down at the long as well as at the short end of the spectrum. Our financial institutions are generally strong, and "credit crunch" is one American expression which has not found ready applicability in Canada. Two sectors which are often in the vanguard of recovery are the housing sector and the stock market, both of which have shown some improvement in recent months. So, there are some reassuring features in our situation and even some hopeful signs of better times around the corner. As people come to count on price stability, interest rates will behave in a much more acceptable fashion. That will be good for the economy generally -- and for your business too.