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to

The Canadian Club, Oakville
Oakville, Ontario
28 October 1992

Notes for remarks by
John W. Crow
Governor of the Bank of Canada
to The Canadian Club, Oakville
Oakville, Ontario
October 28, 1992

This is not the first time I have addressed a Canadian Club, but it is the first time I have spoken in Oakville. Thank you for inviting me.

My remarks come right after the referendum. I shall not discuss the referendum as such. But of course the referendum campaign and the hopes and concerns that it generated have had an effect across financial markets, and therefore a very direct impact on the environment in which the Bank of Canada has to operate.

As I have already suggested, the Bank does not conduct monetary policy in a vacuum. What we can do at any given time is greatly influenced by the attitudes of savers and investors. But we can influence those attitudes constructively, particularly through the steadiness and confidence we are able to impart. The Bank of Canada Act puts it well, if somewhat generally, when it bids us to conduct policy "in the best interests of the economic and financial life of the nation." In this light, our basic goal might be expressed as aiming to bring about good results for the Canadian economy by the actions we can take to encourage saving and investment.

Now, money is what monetary policy is about, and what the Bank of Canada has to work with. So for the Bank to make a good contribution to the economic and financial life of the nation, to encourage saving and investment, Canadians need confidence in their money and in its future value. This is the bedrock of good national monetary policy. Without confidence in money, monetary policy cannot help the economy to generate the output, jobs and rising living standards that we all wish to see. How could it?

Let me turn now from the nature of monetary policy to the monetary policy environment.

All kinds of elements in this environment might be singled out, depending on the circumstances at any particular

time. However, two aspects are constant, crucially relevant for monetary policy, and stand out strongly today. One is the evolution of the economy, and what monetary policy might do to help it to progress. The other is the state of expectations and confidence among savers and investors -- particularly as this shows up in financial markets. These two aspects are of course not unconnected, certainly not in what the Bank of Canada can hope to do.

I will begin with the economy.

While the Canadian economy has been expanding, it has been expanding less rapidly than during typical economic cycles of recession and recovery.

As pointed out in last year's Bank of Canada annual report, this disappointing sluggishness has a number of causes, some generated abroad and some which are Canadian.

Perhaps the most general cause is something that happened a few years ago, when quite a number of industrial countries went through a burst of debt-financed spending in various sectors. Credit was easy to come by for all sorts of endeavours. For a time this generated a glow of abundance, with no apparent limits to spending or to asset accumulation, or to asset-price inflation. In Canada, this was particularly true of southern Ontario. But the party could not last, and it left a trail of assets difficult to finance and debts difficult to carry.

Businesses, governments and households in Canada and abroad have been affected in varying degrees of severity. The severity has depended very much on the extent to which they went overboard with spending and debt in the first place. For example, it is certainly the case that the real estate boom here in southern Ontario and Ontario's budgetary policy in that earlier period have left behind quite a few questionmarks. One more recent general effect that has impacted Canada has been weaker than normal demand abroad for our exports, as other countries try to dig out of their own excesses. The U.S. recovery has also been slow, and Europe and Japan are still slowing.

Another element in the picture is that the international economy is becoming more competitive as economic barriers break down and the world becomes, inevitably, more global. This has demanded, in Canada as well as abroad, an increased attention to efficiency and flexibility of production. This process goes, of course, under the general heading of "restructuring." While in the short run restructuring can act as a drag on demand, the future benefits from doing things smarter are enormous. This is at the heart of economic progress and a rising standard of living.

It is not enough, however, to explain why recovery up to now has been slow. We must also see to it that the policies being pursued can help to promote sustained growth, sustained prosperity, in the future.

With the best will in the world, there are no magic solutions. But the absence of such solutions does not mean that following good policies -- sound policies -- will not make a valuable difference. You will also appreciate that monetary policy is not the only policy in town, that provincial economic policies are important as well as federal policies, and that many circumstances are outside the scope of monetary conditions. But the Bank of Canada's job is to get monetary policy right. So I will focus on what monetary policy is accomplishing for that reason, and also because it is important for this province and every other province -- indeed, for the nation. I will in that regard just add here what I have explained in more detail on many other occasions, that monetary policy has inevitably to be conducted on a national, not a provincial, basis.

Let me begin these comments on monetary policy's role by underlining the indispensable. After three difficult decades, confidence in the value of money is beginning to return. We have to go back to the decade of the mid-1950s to '60s to find rates of inflation as low as those today. Then, inflation averaged under 2 per cent annually. It is also worth emphasizing that during this same period the economy grew by over 5 per cent a year and productivity by over 2 1/2 per cent a year. So much for the view, apparently strongly held in some quarters, that we need inflation in order to grow.

In the following two decades our inflation accelerated, averaging 7 per cent a year and also showing wide swings, and our economic performance worsened.

The essential thrust of monetary policy in the past decade has been to make sure that above all we help to extricate the economy from this bad scene. As I have already indicated, this takes time. But we are succeeding. Indeed, I believe we have come a very long way towards realizing the goal of price stability.

The marked improvement in inflation and greater confidence in a non-inflationary future have been behind the major downward trend in interest rates in Canada over the past two and a half years. This downtrend has been registered across the entire spectrum, out to the longest-term debt maturities in our markets. Indeed it has gone to the point of raising concerns among savers that rates of interest have become too low. I have received quite a few letters to this effect. Fortunately, I am able to point out that the assets earning this interest return are now, finally, being well maintained in value -- in their purchasing power over the goods and services people buy. In the

past, high interest rates were a compensation of sorts for the loss in value that savings were prone to suffer. Assurance that inflation will not be allowed to destroy their finances is vital to savers and to people on fixed incomes generally.

Furthermore, these accumulated savings in Canadian dollars are someone else's debt. So those who want low interest rates for debt servicing purposes also have a stake in price stability. Everyone wins from price stability, and those who think that inflationary policies bring low interest rates are thinking in technicolour.

To reiterate, maintaining progress in achieving price stability is fundamental to monetary policy. It is essential to the improving climate of inflation expectations on which monetary policy's contribution to economic recovery rests.

This is of course showing up in the housing market, where the enormous gains in affordability are having a large impact on traffic, sales and hence on construction. In the way I have just indicated, debt service burdens have lessened with improvements in inflation. Furthermore, great gains have been made in competitiveness. Canadians are increasingly discovering foreign markets and sales opportunities where they can compete through cost and quality, and export volumes are rising, notwithstanding sluggish markets abroad.

The inflation reduction targets announced in early 1991 are a means to an end. Their purpose is to provide further encouragement to Canadians to base their economic decisions on a downward path for inflation, given the assurance of a monetary policy commitment to price stability.

The reduction in inflation to date has gone better than was originally anticipated. The rise in consumer prices is at present below the lower band of the target path for getting inflation down -- 2 per cent by the end of this year. Looking behind the inflation numbers themselves, what is particularly important is the fact that costs of production in Canada are now under much better control. In particular, this environment of cost containment can help us to absorb the impact from the recent decline in the external value of our currency and so maintain progress in achieving price stability and improve our competitiveness further.

Normally, this might be an appropriate place to bring my remarks to an end -- but not on this occasion.

As you are aware, the most recent headlines, even the ones related to the Bank of Canada, have not been directed at what I have been discussing this evening. The news has focussed on the drama of financial markets rather than on the underlying

policies through which the Bank of Canada can bring about good results over time.

Since the Bank of Canada has had lots of eyes trained on it as it goes about managing monetary policy in financial markets -- money markets, exchange markets -- that have been extraordinarily volatile, let me conclude with a few comments on recent market developments.

Of course it is not the markets themselves that generate the volatility. They are at the end of the day the reflection of the uncertainties and tensions among savers and investors. And while those tensions and uncertainties are not caused by monetary policy, they are something to which monetary policy has to react, and with which it has to cope.

In these challenging circumstances, our aim has been to ensure that monetary policy actions are a force for steadiness rather than adding to the uncertainties and tensions. This means, as always, keeping a careful eye on both money markets and exchange markets in the particular actions we take on a day-to-day, week-to-week, basis. Ultimately, our actions at any given time have to pass the test of ensuring that the fundamental contribution of monetary policy -- price stability -- is achieved.

One point in this should perhaps be emphasized. On occasions when the demand among investors (Canadians or non-Canadians, it doesn't really matter) to hold claims in Canadian dollars was less strong, the goal of low interest rates would not be served by Bank of Canada actions that pushed still more Canadian claims, even liquid ones, onto the market. In other words, an expansionary money supply policy on our part would in such circumstances hurt, not help, in bringing interest rates down. This is because the problem is not one of liquidity, but rather one of uncertain expectations in the marketplace. In that situation what must be addressed are the expectations.

How can monetary policy help? It can help by continuing to be clear about the basic goal of monetary stability, as I trust I have this evening, and by continuing to keep it front and centre in its actions. This goal is good for expectations, good for markets, good for savers and investors, and therefore, good for sustained recovery in the Canadian economy.