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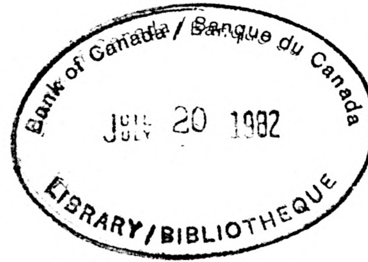


Introductory remarks
by Gerald K. Bouey
Governor of the Bank of Canada
in an appearance before the
House of Commons Standing Committee
on Finance, Trade and Economic Affairs
Thursday, March 25th, 1982

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My latest Annual Report was published less than a week ago. In those circumstances I think I can be brief in these introductory remarks, limiting myself to a summary of some of the main points of that Report.

My main concern has been to deal with the issue of interest rates in Canada. The Bank is very much aware of the pain and frustration that interest rates have caused and are causing. Like others, the Bank wants lower interest rates. Much of what I had to say was devoted to explaining that the only sure route to lower interest rates was through lower inflation. By restraining the rate of monetary expansion, monetary policy is doing the only thing open to it to reduce inflation and reduce interest rates.

I emphasized in the Annual Report that Canada's history as regards inflation and in dealing with it had given rise to strongly entrenched expectations about continuing high inflation. It does not seem to me that Canadians are yet convinced that public policies will be firm

or persistent enough to bring about a substantial reduction in the rate of inflation in Canada. Such embedded expectations make the return to a better economic performance in Canada much more difficult. But it will not be made easier by a return to policies of rapid monetary expansion. In fact we would finish up in a more difficult position, and with higher interest rates, than we have now.

Market conditions are no longer conducive to rapid rises in costs and prices. It is now in the interests of both business and labour that they respond by moderating price and income increases in order to protect employment and output. Businesses that are not able to be competitive will generate neither profits nor jobs. In those sectors of the economy that are not directly exposed to market pressure what is required is that they do not lag the exposed sectors in restraint on increases in incomes. The public sector must recognize its share of responsibility for keeping Canada's costs competitive. So far one sees much more evidence in the United States than in Canada of the responses needed to bring down inflation.

The Bank of Canada announced several years ago that it was going to slow the rate of monetary expansion in a gradual manner. It hoped that this approach would be useful in smoothing the transition to a less inflationary economy. It would give those groups that have the power to influence the prices of the goods or services they supply the chance to adjust their practices accordingly.

Things have not worked out as well in this regard as one would have wished. I have dealt with the reasons for that in my Report. It is clear in retrospect that the resistance offered to inflation by monetary and fiscal policy taken together was not tough enough. If monetary policy had been easier, our situation today would be worse, not better.

I discussed at some length questions related to the implementation of a policy of restraining monetary expansion. I will not review that territory in any detail at this point. However, I want to stress that it has been possible for the Bank of Canada to reconcile the overriding need to control the rate of monetary expansion over time with some freedom to respond to short-term disturbances of either domestic or foreign origin. It has been able to moderate the effects on Canada of sharp swings in U.S. interest rates, and interest rates in Canada have not in fact moved in lock-step with those in the United States. The Bank has also been able to moderate the effect of sharp swings in the flow of capital across our borders. In the summer of 1981 the Bank moderated the effect on the exchange rate of a wave of take-overs by Canadians of businesses in Canada but this required a rise in interest rates at that time.

There is no doubt that monetary policy has an essential role to play in restoring a money that can be trusted -- one that keeps its value over time. But it is also true that the achievement of a better functioning economy depends very heavily upon the policies pursued in

other areas. The more other policies are aimed in the direction of encouraging less rather than more inflation of costs and prices in the Canadian economy, the smoother will the transition to a non-inflationary economy be.

The Bank recognizes that getting inflation down is difficult but the cost of failing to deal with inflation would be very great. Too little attention is paid to the cost of temporizing with inflation. To back off from anti-inflationary policies when the going gets tough would be to enter upon a stop-go cycle of stagnation and inflation. Nobody wants that.

Canada is not alone in this matter. Perhaps we can draw courage from the fact that almost every country in the world is trying to deal with inflation in order to restore a solid basis for economic growth.