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Remarks by David Longworth
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CHECK AGAINST DELIVERY

Promoting Canada's economic and financial well-being

Good morning. It's a pleasure to be here. I'd like to thank the Greater Summerside Chamber of Commerce for hosting this event.

In addition to Michael O'Brien, the Bank of Canada's Director for Prince Edward Island, I'm here with Allan Paquet and David Amirault, who are the Bank's representatives in the Atlantic provinces for, respectively, currency and economics. Allan and David are the Bank's eyes and ears for this region, and they help us to keep on top of various currency and economic developments. For example, David has been monitoring how the global recession and price movements have been affecting PEI industries such as the fishery and tourism.

I'd like to take this opportunity today to describe the Bank of Canada's work in very general terms. Until recently, some people were given to thinking that central banking is − what shall I say? − a *staid* business. But the past two years have proven to be extremely interesting, not only for us at the Bank of Canada, but for all our central bank colleagues around the world.

The Bank's mandate is to promote Canada's economic and financial well-being. Clearly, this is an important mandate, and we are determined to demonstrate excellence as we work to fulfill it. We conduct leading-edge research and analysis, and, in doing so, we aim to be "second to none" among the world's central banks.

To fulfill our mandate, we work in four main areas of responsibility: currency, funds management, financial system, and monetary policy.

For each of these areas, the Bank's approach is much the same. First, we have a *clear objective*. Second, we tend to take a *longer-term view* of things. Third, we make ourselves accountable by being *transparent* about the tools we use, the actions we take, and the outcomes of our actions. And, finally, we keep the *big picture* in mind.

In my remarks today, I'll talk about each area of responsibility, with particular emphasis on the last two − financial system and monetary policy.

Currency

Bank notes are the Bank's most tangible product, and, despite the prevalence of credit and debit cards and other means of payment, the demand for cash continues to grow. The objective of our currency function is to provide Canadians with bank notes that are readily accepted and secure against counterfeiting. In fact, we quantified this goal as fewer than 100 counterfeit notes detected annually per million notes in circulation, and we are now meeting this standard. But we intend to make further progress, and our new goal is fewer than 50 counterfeits detected annually per million notes in circulation.

For some time, the Bank has been developing Canada's next bank note series, which we expect to start issuing in late 2011. Planning for a new series of bank notes is a complex job, and so necessitates taking a long view. Our anti-counterfeiting strategy is also a long-term proposition. It contains four elements. The first is to develop bank notes that are ever-more difficult to counterfeit. The second is to increase the routine verification of bank notes by retailers − our regional staff play an important role here by helping in the training of retailers and cash handlers. The third element of the strategy is to maintain the high quality of bank notes in circulation. And the fourth is to promote the deterrence of counterfeiting by law-enforcement officers and prosecutors. Regional staff also play key roles in supporting these last two elements of the strategy by liaising with financial institutions and with law-enforcement agencies.

As part of its deterrence work, the Bank has established an annual "Law Enforcement Award of Excellence for Counterfeit Deterrence." This year, the award was presented in Charlottetown to the RCMP's National Anti-Counterfeiting Bureau during the conference of the Canadian Association of Chiefs of Police.

Transparency is also important in our currency work. In addition to reporting on the incidence of counterfeiting vis-à-vis our targets, we communicate regularly with the public and retailers about the security features in our bank notes, and we publish the costs of the currency program in our annual report.

As to keeping the big picture in mind − well, currency is only one of several means of payment. The Bank conducts research on the factors that influence choices in means of payment, and we monitor trends. This helps us to understand the role of bank notes in transactions, and to forecast demand.

I'll now say a few words about the Bank's second area of responsibility: funds management.

Funds management

The Bank of Canada is the federal government's banker, fiscal agent, and adviser on funds management. The objective of this work is to provide these services effectively and efficiently. The responsibility includes managing Canada's foreign exchange reserves, the government's cash, and, in collaboration with the Department of Finance, the public debt, including Canada Savings Bonds, which go on sale this year on October 5. As part of this responsibility, the Bank also gives advice to the Department of Finance on these issues, as well as on issues that have arisen in the context of the financial crisis. For example, our advice fed into the design of the Insured Mortgage Purchase Program, which allowed the federal government to buy pools of insured mortgages through the Canada Mortgage and Housing Corporation, as well as the design of the Canadian Secured Credit Facility, which was set up to purchase asset-backed securities.

Managing and providing advice on debt and reserves also require taking a long view. Generally speaking, the management of financial assets and liabilities requires a forward-looking risk-management framework, as well as long-term strategies.

And of course it's essential to be completely transparent when it comes to managing government funds and public money. The Bank discusses the various tools it uses and reports on the operations and actions it carries out to manage financial assets and the outstanding stock of federal debt. It does this via its own website, the Department of Finance's website, and in the Bank's annual report.

Finally, in our funds-management work, we always look at the big picture. The range and complexity of operations and the need to carefully manage risk require us to consider a very broad picture when we develop our framework for the governance of funds management and formulate our policies.

Now I'll turn to the Bank of Canada's third area of responsibility − the financial system.

Financial system

As recent events have made clear, a sound financial system is essential to a well-functioning economy. The objective of the Bank's work here is to promote the stability and efficiency of the financial system, both domestically and globally.

To achieve this objective, we again take the long view. Together with other policy-makers in Canada and abroad, the Bank strives to develop, and contribute to, policy that will help to sustain a stable and efficient financial system over time. This long-term focus aids in creating and maintaining an environment in which risks can be properly assessed and sound investment decisions effectively made. That said, we also have to be nimble, and react quickly to market developments. For example, since the onset of the financial crisis, we have provided considerable liquidity to the Canadian financial system, in a variety of forms. We currently auction liquidity three times a week.

It is extremely important for a central bank to be transparent in its financial system work. In our *Financial System Review* we communicate, on a regular basis, our assessment of the key risks and vulnerabilities, as well as our analysis of certain policy issues. We also provide clear information about our operations. For example, as the Bank provided liquidity, we communicated clearly and in a timely fashion, the relevant policies and principles, the facilities we were using, and the scale of our operations, as well as the status of key markets.

Financial markets have improved to such an extent that the demand for our term liquidity facilities has been waning. Of the three facilities that we offer, there is currently no demand for the Term Loan Facility, demand for the facility for Private Sector Instruments has recently been half of what we have been auctioning, and even demand for Term Purchase and Resale Agreements, our “workhorse” facility, has declined as conditions in funding markets have improved. Against this background, the Bank announced yesterday that the first two facilities will expire at the end of October, and that the auctions for the third facility will now be held bi-weekly instead of weekly.

Of course, the financial system has many interdependent elements, and we again must keep the big picture in mind. This is especially true in our monitoring of the financial system, in our assessment of risks, and in our policy analysis. In the current context, two aspects of our policy work are worth noting. First, there were times during the financial crisis when liquidity dried up in almost all financial markets. However, not all markets are critical to the proper functioning of the financial system, so the Bank has been working to identify “core” markets, markets that, through appropriate policies, we would strive to keep operating without interruption, even during a shock. Second, because the regulatory system has tended to focus more on individual financial institutions than on interdependencies or systemic risk, the Bank of Canada, like many other central banks, has been looking at ways to strengthen financial regulation by adding a “macroprudential” orientation − that is, more focus on the system as a whole.

I’ll turn now to the Bank’s fourth and final area of responsibility: monetary policy.

Monetary policy

Monetary policy can get complicated, but the objective is straightforward: it’s to foster confidence in the value of money by keeping inflation low, stable, and predictable. In an agreement with the government of Canada, the Bank has an inflation target of 2 per cent, which makes this objective very explicit.

By its very nature, monetary policy work necessitates having a long view. The Bank achieves the inflation target by raising or lowering the target for the overnight interest rate which, in turn, influences other interest rates, and, ultimately, the overall demand for goods and services. This sequence of events takes time, and monetary policy typically tries to influence inflation 6 to 8 quarters into the future. Put differently, monetary policy works with a significant lag, so, when we make our interest rate decisions, we rely on various indicators of *future* inflation, and take a medium-term view of the economy.

Low, stable, and predictable inflation brings about real benefits. It allows consumers, businesses, and investors to read price signals clearly, and thus to make financial decisions with confidence. It allows businesses to make long-term investments which, in turn, contributes to sustained job creation. And, importantly, it helps to make the economy more resilient to shocks.

Many of you will remember the days of high and variable inflation, and can therefore appreciate the progress we've made. Since 1995, total CPI inflation has averaged 2 per cent per year. That's a good record, but the Bank is always looking at ways to strengthen its tools and the outcomes of monetary policy.

In response to the global financial crisis and recession, the Bank's monetary policy has been very aggressive, and since April of this year, the target for the overnight rate has been one quarter of one per cent − that's effectively as low as it can go. In other words, we cannot lower our policy rate any further to provide economic stimulus. Recognizing the possibility that additional stimulus might be required, we researched and identified three additional monetary policy tools that we could use. The Bank has not used the first two tools − quantitative and credit easing, which involve the purchase of assets − but they remain available to us.

We have, however, employed the third tool identified, and that is the use of "conditional statements" about the future path of monetary policy. In our April monetary policy decision, we said that, conditional on the outlook for inflation, the target overnight rate could be expected to remain at its current, very low level until the end of the second quarter of 2010. This longer-term guidance helps to influence interest rates at longer maturities.

The Bank has also been examining whether the inflation-control framework might be improved. Specifically, in advance of the next agreement that we'll sign with the federal government in 2011, we've been studying whether 2 per cent is the best target, and whether the target should be (as it currently is) the rate of inflation or the path of the price level.

All to say, our monetary policy work really does take a long view of things.

Now a word about transparency in monetary policy. I've spoken about the tools we use to achieve the inflation target. With regard to our actions, we make our policy rate decisions eight times a year on a fixed schedule, issue a press release each time, and, four times a year, explain our analysis and projections in detail in our *Monetary Policy Reports*. The outcome of monetary policy − total CPI inflation − is measurable, and our performance is transparent. I should add a word about "core" inflation. The more volatile price components of the CPI − such as fruit, vegetables, and gasoline, as well as the effect of changes in indirect taxes − can cause a good deal of *temporary* movement in total CPI inflation, so the Bank of Canada uses a core measure of inflation, which excludes these volatile components, as a useful guide to policy. The core measure of inflation helps us to "see through" short-term volatility when we make our policy decisions.

As to keeping the big picture in mind: monetary policy focuses on the Canadian economy *as a whole*, and aims to achieve a *national* inflation rate. Of course, to get a sense of the national economy, we need to closely monitor regional developments. We have five regional offices across the country, including the Atlantic region office in Halifax, from which our staff go out to visit businesses and gather information on issues related to the economy. We communicate the highlights of this information in our quarterly *Business Outlook Survey*, which is available on our website.

So those are the four areas of responsibility in which the Bank of Canada works to carry out its mandate.

Before I conclude, I'll say a few words about the economic outlook and the monetary policy decision announced on 10 September.

The press release that accompanied the announcement noted that, following a deep, synchronous, global recession, recent indicators point to the start of a recovery in the major economies, supported by aggressive policy stimulus and the stabilization of global financial markets. In Canada, stimulative monetary and fiscal policies, improved financial conditions, firmer commodity prices, and a rebound in business and consumer confidence are supporting the growth of domestic demand. Combined with recent information on inventory adjustments and automotive production, this suggests that GDP growth in the second half of 2009 could be stronger than we projected back in July. Total CPI inflation is expected to trough in the current quarter before returning to the 2 per cent target in the second quarter of 2011 as aggregate supply and demand return to balance.

The Bank said that, conditional on the outlook for inflation, the target overnight rate could be expected to remain at its current level until the end of the second quarter of 2010 in order to achieve the inflation target. The underlying macroeconomic risks to the projection were judged to be roughly balanced. We also noted that persistent strength in the Canadian dollar remains a risk to growth and to the return of inflation to target, and that the Bank retained considerable flexibility in the conduct of monetary policy at low interest rates.

Finally, it would be timely to mention that, earlier this week, the Bank launched its new medium-term plan. The plan sets out the key priorities for the Bank over the next three years, discusses relevant trends and challenges, and lists the measures by which we will gauge our performance and make ourselves accountable. This plan, which will soon be posted on our website, guides our work over the medium term. It shows that having clear objectives, taking the long view, being transparent, and keeping the big picture in mind, will continue to be our approach in the years ahead.

Conclusion

The past two years have been difficult for many Canadians. The financial crisis and the recession have taken an economic toll, and they have tested our confidence.

However, Canadians *can* have confidence in their central bank. Specifically, you can be sure that the Bank of Canada will continue to promote the country's economic and financial welfare, communicate its objectives clearly, and stand accountable for its actions. And we will continue to demonstrate a commitment to excellence in all our work.

These commitments will help to strengthen the economy in both good times and bad, and they will help to sustain a stable and efficient financial system.