BANK OF CANADA

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**Bank of Canada Governor speaks to
the Kelowna Chamber of Commerce**

KELOWNA, B.C. – "Low and stable inflation is good for business, good for the consumer, and good for the economy as a whole," Bank of Canada Governor Gordon Thiessen told the Kelowna Chamber of Commerce today in a luncheon speech that focused on the contribution that monetary policy makes towards an environment that supports economic activity.

Mr. Thiessen also emphasized that monetary policy has to be forward-looking. Because of the relatively long time it takes for monetary policy actions to work through the economy and have an effect on inflation—some 18 to 24 months—such actions are based on considerations about the future, not the current, rate of inflation.

Moreover, monetary policy decisions are based, first and foremost, on economic prospects here in Canada, he said. While economic developments in the United States are important to Canada, a decision by the Bank of Canada to follow, or not, the U.S. Federal Reserve "depends on what we think is necessary to keep the Canadian economy on a non-inflationary, and thus sustainable, growth path."

The Governor noted that our economy has outperformed expectations since mid-1999 because of stronger-than-expected demand for Canadian products from both foreign (especially U.S.) and domestic sources. The Bank of Canada raised interest rates four times over the past 12 months, while the Federal Reserve raised rates six times. On each of those four occasions, the Bank decided that the implications for Canada of a potential buildup in demand and inflation pressures in the United States, together with strong domestic spending in Canada, justified higher rates here too.

As we look ahead, Mr. Thiessen said that "assessing the balance between total demand and supply in the economy and the implications for inflation will be an ongoing challenge for monetary policy." With estimates of production capacity being more uncertain these days, because of ongoing major structural changes, the Bank is taking a cautious approach to projecting a permanently higher rate of growth in our economy's capacity to produce.

Still, the very favourable price performance since late last year seems to suggest that the Canadian economy has not been pressing as hard against capacity as we had thought, the Governor noted. This gives the Bank some more room to explore where the limits of that capacity really are.

Mr. Thiessen concluded that, “Nonetheless, we must not be lulled into thinking that the threat of inflation has disappeared. Given the strong momentum and high levels of activity in our economy, and given the time that it takes for monetary policy actions to affect output and prices, the Bank must remain vigilant.” For “nothing will bring the present expansion to an abrupt halt more quickly than an outbreak of inflation.”