BANK OF CANADA

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Bank of Canada Governor concludes that a floating exchange rate regime continues to make sense for Canada

MONTREAL, P.Q. – In a speech to the Chambre de commerce du Montréal métropolitain, Bank of Canada Governor Gordon Thiessen reviewed the different sides of the argument with respect to a floating exchange rate regime, and concluded that a floating currency continues to make sense for Canada.

Mr. Thiessen acknowledged the attractions of the reduced currency uncertainty and lower costs for cross-border transactions that would be part of a fixed exchange rate arrangement with the U.S. dollar. He noted, however, that the only way to do this would be "not through a fixed exchange rate but through some sort of currency union with the United States." In reality, "a monetary union with the United States could only mean that Canada would adopt the U.S. dollar," he said.

The Governor stressed that the choice of exchange rate regime has much broader implications than just transactions costs. He argued that "the real value of a floating exchange rate for Canada is that it allows us to have different monetary conditions than the United States—monetary conditions appropriate to our own economic circumstances."

To illustrate the importance of this, Mr. Thiessen drew on two examples from recent Canadian experience—the sharp decline in world commodity prices during the Asian financial crisis of 1997–98 and the fiscal consolidation efforts undertaken beginning in the mid-1990s. While recognizing that it is possible to cope with such unexpected shocks and policy differences under a fixed exchange rate or a monetary union, he pointed out that "the adjustment process will take longer, will be more difficult, and will cost more overall" than under a floating rate.

The Governor thus concluded that "for Canada, the macroeconomic advantages of a flexible exchange rate continue to far outweigh the lower transactions costs of a fixed rate. As long as we remain a major producer of primary commodities, and as long as we want to pursue separate economic policies that are suited to our own circumstances and that require differing monetary conditions, the shock-absorber element of a floating currency will serve us well."