BANK OF CANADA

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Bank of Canada Governor speaks to the Canadian Society of New York

NEW YORK, N.Y. – In a speech today to the Canadian Society of New York, Bank of Canada Governor Gordon Thiessen talked about Canada's experience with a floating exchange rate and an independent monetary policy, despite close integration with the much larger U.S. economy.

Mr. Thiessen explained how a floating exchange rate helps Canada adjust to shocks that, even when similar in nature, affect the Canadian economy differently than that of the United States.

He also pointed out that a floating exchange rate allows Canada to have an independent monetary policy. The essence of such independence lies in "...having the option and the ability to respond to fluctuations in demand that are unique to our economy."

The Governor underscored the importance of credible macroeconomic policies for the effective operation of foreign exchange markets. "No exchange rate system is going to bail you out of bad economic policies," he said. "And that is equally true of a floating exchange rate system as it is of the alternatives—a fixed exchange rate system or indeed a monetary union, even if that monetary union is with the world's largest, strongest economy."

Mr. Thiessen told his audience that "without a sound fiscal policy and without a strong, explicit commitment to inflation control [which, in Canada's case, means a commitment to specific targets], exchange markets will not have full confidence in the underlying value of the currency. And the ability of a flexible exchange rate to respond to shocks and to facilitate the interest rate movements needed for an independent monetary policy will be seriously compromised."

Mr. Thiessen concluded that a flexible exchange rate continues to serve Canada well in dealing with the challenges of a changing, increasingly open world economy.

With respect to the economy, the Governor reiterated the message from last month's *Update* to the *Monetary Policy Report* – of stronger-than-anticipated demand for Canada's output from both foreign and domestic sources. While the core rate of inflation remains in the bottom half of the 1 to 3 per cent target range, given the momentum in aggregate demand and the uncertainty about the production potential of the economy, the Bank of Canada will have to be vigilant and ensure that inflation remains low and stable. "Without that, we will be risking both the economic expansion and the potential productivity gains."