BANK OF CANADA

FOR IMMEDIATE RELEASE
17 February 2005

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Governor Dodge Discusses the Implications of Currency Movements for Monetary Policy

VANCOUVER, BRITISH COLUMBIA—Bank of Canada Governor David Dodge said today, that in conducting monetary policy, the Bank analyzes movements in the Canadian dollar in the context of economic and financial data and events. The Governor was expanding on a technical box on monetary policy and exchange rate movements that appeared in the Bank's latest *Monetary Policy Report Update*.

In a speech to the Vancouver Board of Trade, Governor Dodge said that it is important for the Bank to try to distinguish between two types of exchange rate movement: those that reflect direct changes in aggregate demand for Canadian goods and services and those that do not. These two types of currency movement have different implications for the balance of demand and supply in the economy and, hence, for monetary policy.

"This is a complicated issue, all the more so because both types of currency movement sometimes occur at the same time," Governor Dodge said. "But it is important for us at the Bank, and for those who follow our actions, to understand what is causing the exchange rate to move. This is because the monetary policy implications of a currency movement depend on its cause and on what other forces might be at work in the economy."

Governor Dodge noted that the relationship between the exchange rate, the economy, and monetary policy is complex and the effects of currency movements occur over time. "There is no precise way to measure the relative importance of the two types of movement, . . . or their likely persistence. So, in setting monetary policy, we at the Bank use an analytical framework based on historical evidence, assess a lot of current data and, even then, we must apply a lot of judgment to our analysis," he said. This analysis is the basis on which the Bank conducts monetary policy with the goal of maintaining a rough balance between demand and supply in order to keep inflation low, stable, and predictable.