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**to the Metropolitan Halifax**
**Chamber of Commerce**
**Halifax, Nova Scotia**
**27 January 2000**

# Accountability and transparency in Canada's monetary policy

Public sector institutions have been undergoing significant changes over the past decade. One of the most important changes has been the move to greater accountability. Public institutions are now required to be more open and to provide more information about their operations. Or, to use the word currently in vogue, to be more "transparent."

Nowhere has this move towards greater transparency been more dramatic than among central banks in the major industrial countries. Traditionally, central banks had been rather closed, almost mysterious, institutions. This reflected the view that financial markets needed to be "surprised" if monetary policy was to have a significant effect. In recent years, the philosophy behind monetary policy in Canada, and in most major countries, has been moving in the other direction. Not only does this reflect the need for accountability, but also the fact that central banks have come to appreciate that transparency can actually lead to better policy outcomes.

Today, I would like to tell you about some of the steps we have taken to increase transparency in the conduct of Canadian monetary policy. In keeping with this theme, I will also take this opportunity to bring you up to date with the Bank's view of recent economic developments at home and abroad and tell you how the outlook shapes up. I will also discuss what monetary policy is doing to keep the current economic expansion in Canada on a sustainable course.

## Accountability and transparency in monetary policy

I would suggest that what is absolutely crucial for the accountability and transparency of public institutions is *clear objectives*. This is certainly true for monetary policy.

In Canada, a major step towards greater openness was the adoption in 1991 of specific targets for inflation reduction. Inflation was quickly brought down and, since 1994, the objective has been to keep it low and stable—within a range of 1 to 3 per cent. This explicit target is a precise yardstick for measuring the Bank's success or failure and, thus, provides the basis for our accountability to the public.

But as I have said many times in the past, low inflation is not an end in itself. We focus on low inflation because it contributes to a more productive, stable, and prosperous economy. So ultimately, our accountability must be seen in terms of inflation control as a means to better overall economic performance.

Interestingly, once a central bank has adopted an explicit inflation target, as we have, and is held to account for it, the move towards greater transparency is speeded up. For it quickly becomes apparent that monetary policy will be more successful in meeting the target if both the public and financial markets understand the factors affecting inflation as well as the central bank's assessment of those factors and its likely response.

Here in Canada, we found that, as we consistently met our targets, public expectations about future inflation changed—the more credible the Bank's commitment to the targets became, the more Canadians formed their plans on the assumption that the future trend of inflation would stay inside the target range.

Over time, a credible commitment to inflation control also sets other positive developments in motion. As credibility rises, uncertainty about future inflation diminishes. Interest rates are lower than otherwise and investment in machinery, equipment, and technology increases, leading to stronger economic growth in the longer run.

But that is not all. As Canadians become more confident that inflation will be controlled, they are less quick to react to unexpected disturbances that could affect inflation. This contributes to greater economic stability and gives the Bank of Canada a bit more time to assess the extent and persistence of such disturbances. Greater public confidence thus gives the Bank more latitude to explore the limits of the economy's capacity to produce and to create jobs without setting off inflation pressures that undermine the sustainability of the economic expansion.

Transparency and accountability in monetary policy require effective communication. At the Bank, we have undertaken a series of initiatives to improve our communications with the public.

Five years ago, we redesigned our *Annual Report* to make it a more reader-friendly yearly account of how we have managed the Bank and how effectively we have carried out our main responsibilities.

At that time, we also introduced a *Monetary Policy Report*, which is published every six months—in May and November. This *Report* describes our management of monetary policy and gives the Bank's assessment of recent economic information as well as our outlook for the economy and inflation.

After the release of each *Monetary Policy Report*, we meet with media as well as with business economists and financial analysts. In addition, I appear before a parliamentary committee to discuss the *Report's* contents. Both of these initiatives are important parts of the accountability process.

Six months, however, has been proven to be rather a long time between *Monetary Policy Reports*, especially for market participants and economists who follow monetary policy closely. That is why next month we will issue an *Update to the Monetary Policy Report* from the Bank's Governing Council. It will appear in the Winter 1999-2000 issue of the *Bank of Canada Review*. These *Updates* will be published regularly, every February and August, between issues of the *Monetary Policy Report*.

Because Canada is such a large country with so many diverse economic regions, it is important that the Bank maintain contacts with the public that are country-wide and that involve two-way communication. We need to hear first-hand what is happening to the economy in every corner of Canada. That is why, in 1997, we set up five regional offices, including one here in Halifax for the Atlantic region. Our representatives are in frequent contact with various local associations, businesses, community groups, government officials, colleges, and universities to give and receive information and to exchange views on the economy and monetary policy.

To supplement these contacts, my senior colleagues and I frequently travel across the country to talk to groups, like this, to respond to questions, and to listen to comments and concerns. That way, we ensure that we are heard and also that we hear what is going on from one end of this country to the other.

For those of you who surf the Internet, I should mention that there is also a tremendous amount of information on the Bank of Canada’s Web site. All of our recent publications, speeches, and press releases are there. You will also find short, straightforward notes explaining various aspects of monetary policy as well as information on interest rates and exchange rates. In addition, our site features a rather neat inflation calculator, which allows you to find out what inflation has done to the value of your money over any period during the past 85 years. This can really bring home just how inflation eats into the buying power of money over time.

These are just some of the things we have done to become more open, understandable, and accountable to the Canadian public.

I would now like to give you my reading of where the Canadian economy is, where we are headed, and what it all means in terms of the outlook for inflation and monetary policy.

**The Canadian economy—recent record and outlook**

1999 turned out to be a very good year for Canada. Our economy rebounded strongly from the global financial crisis of 1997-98 and its negative effects on the prices of the key primary commodities we export. When the numbers for the final quarter of 1999 are out, I expect that they will show that the Canadian economy has expanded by close to 4 per cent since the fourth quarter of 1998. And employment has been growing strongly, taking the national unemployment rate down to an 18-year low of just under 7 per cent. Nova Scotia’s economy has also done well this past year, both in terms of output and employment growth. Indeed, when it comes to job creation through the year (that is, December 1999 over December 1998), Nova Scotia has done better than the national average.

A number of factors have supported the economic upswing in Canada. On the external side, we have greatly benefited from an amazingly strong U.S. market. A pickup in growth in Europe and a recovery in some of the Asian economies that were most hurt by the financial crisis have also helped. Another important factor has been the turnaround in primary commodity prices, in response to firmer world economic activity. Stronger domestic spending in Canada, reflecting growing confidence, rising employment, and relatively low interest rates, has also been instrumental in boosting the rate of economic expansion.

When I talked about our economic prospects in Charlottetown in early November and again when our *Monetary Policy Report* was released shortly after that, I indicated that the Bank expected a positive picture for 2000. This meant continued healthy growth and an underlying rate of inflation (as measured by the Consumer Price Index, excluding food, energy, and the effects of changes in indirect taxes) near the middle of our 1 to 3 per cent target range.

Information received since then suggests that in the future there may be more upward momentum of demand in Canada than we thought because of greater strength both in the world economy, especially in the United States, and in global commodity markets. So we may be looking at a somewhat faster pace of economic expansion for this year—in the upper half of the 2 ¾ to 3 ¾ per cent range that we suggested in the autumn.

I also pointed out last November that there were inflation risks in the outlook for Canada that the Bank was sensitive to, and should be ready to face, given that monetary policy must be forward-looking. I highlighted two risks in particular: a potential buildup of inflation pressures in the United States that could spill over to Canada; and the possibility of a much stronger momentum of demand in this country from both domestic and foreign sources.

Economic developments since November continue to point to these risks. And they underline the need for the Bank to be vigilant and ready to act in a timely fashion to safeguard Canada's low trend of inflation. For let us make no mistake: a resurgence of inflation would undermine our chances of a durable economic expansion.

Of course, the challenge for monetary policy is to assess carefully just *when* action is needed. Ideally, we would want our economy to operate at a level that is as close to full production capacity as possible. At this level, inflation will stay low and stable, and the economy can expand at as rapid a pace as is sustainable over time. It is when persistently strong demand pushes the economy to operate well above capacity over a period of time that inflation pressures develop. This is what monetary policy must seek to avoid.

Unfortunately, in practice, it is very difficult to estimate exactly where that sustainable operating level for the economy is. And this is even harder after a period of major restructuring, such as we have experienced in Canada in the 1990s. While *conventional* measures suggest that the economy may now be operating at capacity, it is quite likely that structural changes have raised the output potential of our economy. But we are not sure by how much.

That is why the Bank closely monitors a wide range of indicators that can help it assess the extent of current and future pressures on capacity and inflation. Some of the elements going into this assessment are: unexpected movements in actual inflation; changes in expectations of future inflation; other measures of pressures in product and labour markets; the growth of money and credit; and information gathered by our regional representatives from business contacts across Canada.

Because of the current strong momentum of demand and high levels of economic activity, and because of the uncertainty about Canada's production potential, the Bank must continue to be on guard. It must continue to watch for leading signs of future price and cost pressures and stand ready to respond promptly if such signs emerge.

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To conclude, the Bank of Canada has taken a number of steps to become more open, transparent, and accountable about the conduct of monetary policy. Through a regular flow of reports and speeches like this, we intend to continue telling you where the economy is and where we think it is going, what risks we see out there, and what monetary policy can do to reduce them.

These days, the Bank is sensitive to the increased risks of inflation coming from a more synchronized expansion of the world's major economies. Not only does a buoyant U.S. economy continue to bolster the demand for Canadian products, but firmer commodity prices are boosting our national income and adding to the impetus of domestic spending in Canada.

The Bank remains committed to delivering a trend of inflation that is inside the target range of 1 to 3 per cent. Because the long and the short of it is that low and stable inflation is a crucial ingredient for a durable, healthy economic expansion.