Opening statement by Paul Jenkins
Senior Deputy Governor of the Bank of Canada
to the House of Commons Standing Committee on Industry, Science and Technology
30 January 2008

CHECK AGAINST DELIVERY

Thanks very much, Mr. Chairman. I'm pleased to be here with you today and hope to help your committee as it examines the impact of exchange rate movements on the Canadian economy. With me is John Murray, who was recently appointed as a deputy governor and member of the Bank of Canada's Governing Council.

To begin, as a little background I would like to quickly review the framework within which we conduct Canada's monetary policy. The Bank of Canada Act calls on us to mitigate "fluctuations in the general level of production, trade, prices and employment, so far as may be possible within the scope of monetary action, and generally to promote the economic and financial welfare of Canada." Over time, we have learned that the best way to fulfill this mandate is to keep inflation low, stable, and predictable. Specifically, that means we aim to keep the annual rate of inflation, as measured by the consumer price index, at 2 per cent. To keep inflation on target, we aim for a balance between total demand and total supply in the economy. By maintaining low and stable inflation, our monetary policy helps to keep the economy operating at full capacity and promotes greater stability in economic output. This is crucial in helping the economy to adjust to changing economic circumstances.

Now, what does all of this have to do with the exchange rate? Well, the exchange rate of the Canadian dollar is a key element of our monetary policy framework. Without a floating exchange rate, we would not have the ability to conduct an independent monetary policy appropriate to our domestic situation. This means that we do not have a target for the Canadian dollar. But the exchange rate is an important relative price in our economy and we pay very close attention to its movements. Movements in the exchange rate influence the levels of imports and exports, which can help to keep total demand and supply in balance, and have a direct influence on price levels in our economy. Further, exchange rate movements act as a signal to shift resources into sectors where demand is strongest. Our floating exchange rate helps to facilitate that process. That said, we recognize that these types of adjustment can be, and have been, difficult for some sectors and regions of the country.

When the Canadian dollar rises or falls, we try to determine the degree to which those movements are due to changes in world demand for our goods and services, and how much is due to other, unrelated factors. It is important that we understand the causes of exchange rate movements, because the implications for the economy – and the appropriate monetary policy response – depend on the reasons for the change. We must then incorporate this information with our assessments of other data, and set a course for

Not for publication before 30 January 2008
15:30 Eastern Time

monetary policy that works to keep total demand and supply in balance, and inflation on target.

Exchange rate movements can also be, as we have seen recently, quite volatile. That has sometimes led to calls, for example, for Canada to fix its currency to the U.S. dollar. That would be a mistake. The United States is certainly our closest neighbour and by far, our largest trading partner. But the structures of our two economies are very different. This means that each of us often requires different adjustments and different policies in reaction to shocks. Canada's floating exchange rate helps in this process by acting as a shock absorber.

We cannot avoid adjustment; the question is how we can best adjust to changing global and domestic economic forces. With a fixed exchange rate, the adjustments would have to come through movements in overall output and in all wages and prices. History has shown that those adjustments are more protracted and more difficult when the nominal exchange rate is not allowed to move. Again, however, I stress that this does not mean that the Bank is indifferent to movements in the exchange rate.

Now, let me conclude with a few summary comments on our latest *Monetary Policy Report Update* released last week. Copies are available for committee members. In this, we said the Canadian economy continues to operate above its production capacity, despite some slowing in growth in the fourth quarter of 2007. The Bank projects that economic growth in 2008 will be weaker than was expected in October, averaging a little over 1 per cent in the first half of this year and a little over 2 per cent in the second half. On an average annual basis, the economy is projected to expand by 1.8 per cent in 2008 and 2.8 per cent in 2009. Both core and total CPI inflation are projected to fall below 1 1/2 per cent by the middle of this year before returning to 2 per cent by the end of 2009. On 4 December and on 22 January, the Bank lowered its target for the overnight rate by one-quarter of one percentage point, bringing it to 4 per cent. In line with the Bank's outlook, further monetary stimulus is likely to be required in the near term to keep aggregate supply and demand in balance, and to return inflation to target over the medium term.

With that, Mr. Chairman, John and I would now be happy to take your questions.