



Central Banking Revealed: How We Promote Canada's Economic and Financial Well-Being

John Murray
Deputy Governor

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Prince George Chamber of Commerce
Prince George, British Columbia
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- What is the Bank of Canada's mandate?
- What are the Bank of Canada's key responsibilities?
- How are they currently being met?
- What is the outlook for the Canadian economy?
- What is the outlook for the British Columbia economy?

Mandate

The Bank of Canada's mandate is to contribute to the economic well-being of Canadians

We do this by:

- aiming to keep inflation low, stable, and predictable
- promoting a stable and efficient financial system
- supplying secure, quality bank notes
- overseeing key clearing and settlement systems

Key Responsibilities

Our mandate is fulfilled through work in four core areas of responsibility:

- Monetary policy
- Financial system
- Currency
- Funds management

Key Responsibilities: The Bank's Approach

In each of those four core areas, we apply the same approach, which consists of:

- a clear objective
- accountability and transparency
- a longer-term perspective

Key Responsibilities: Monetary Policy

Our objective: to foster confidence in the value of money by keeping inflation low, stable, and predictable

This is important because:

- it allows consumers, businesses, and investors to read price signals clearly, and to make financial decisions with confidence
- it reduces the inequity associated with arbitrary redistributions of income caused by unexpected changes in inflation
- it also makes the economy more resilient to shocks and enhances the effectiveness of monetary policy

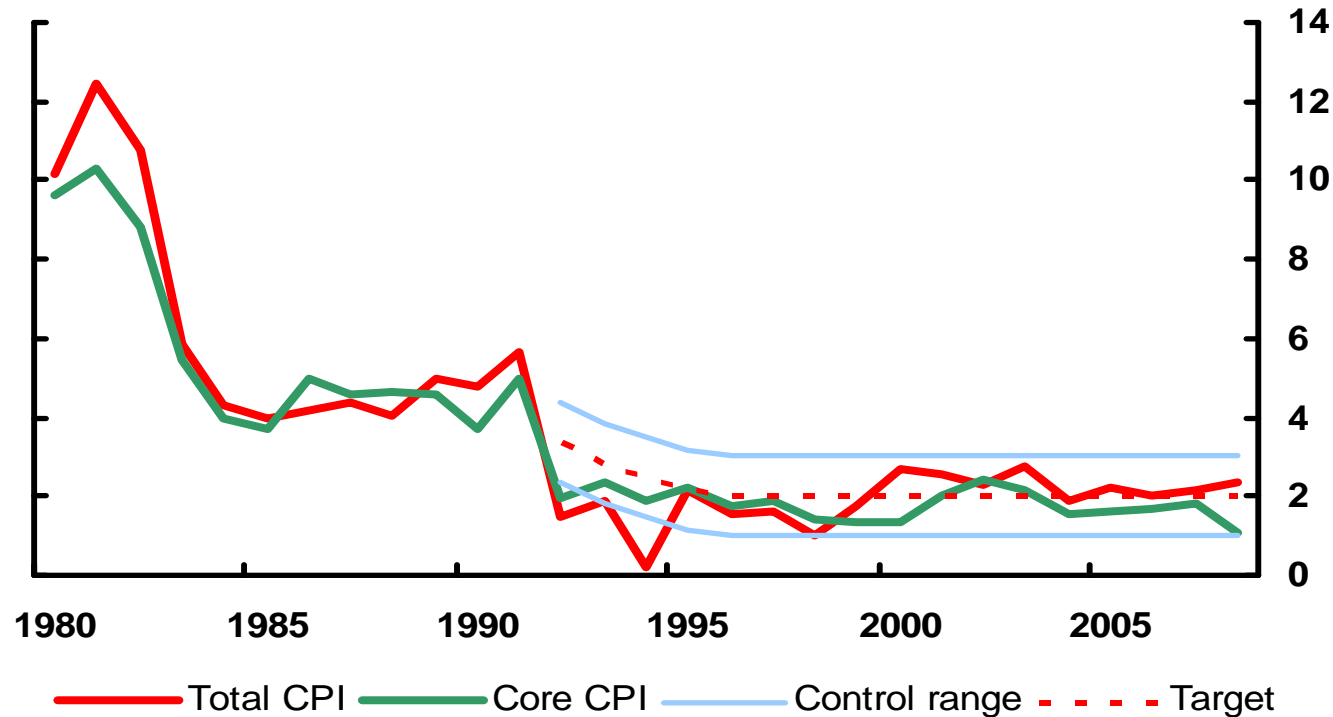
Key Responsibilities: Monetary Policy

- The Bank achieves its inflation target of 2 per cent by raising (or lowering) the target for the overnight interest rate which, in turn, influences other interest rates and, ultimately, overall demand for goods and services
- Changes in monetary policy can take up to two years to have their full effect on inflation, so the Bank must be forward looking and anticipate future changes in inflation
- This requires a longer-term view of the economy

Monetary Policy: Low and stable inflation

CPI annual averages

Year-over-year percentage change



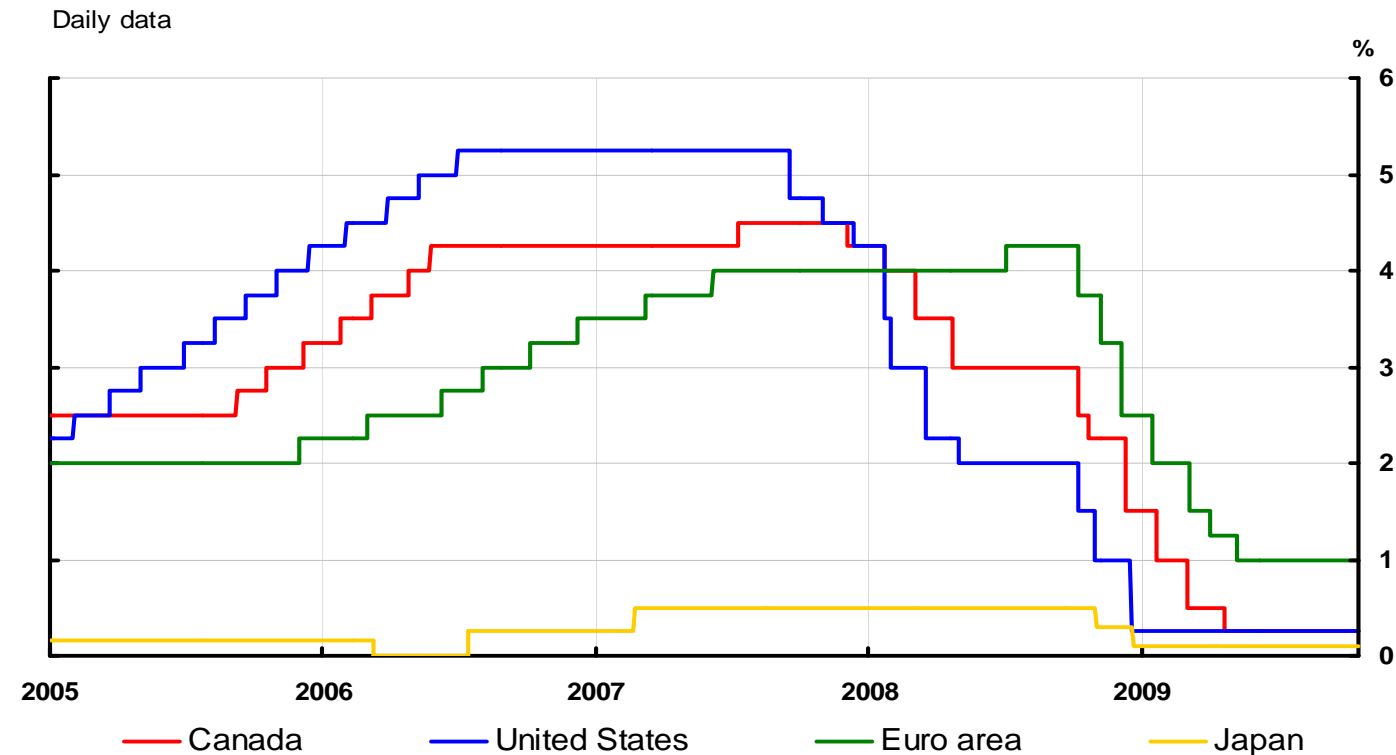
Source: Statistics Canada

Key Responsibilities: Monetary Policy

- The Bank has responded to the global financial crisis and subsequent recession with aggressive policy actions
- It has provided extraordinary liquidity support to the financial system
- And the target for the overnight rate has been reduced to one-quarter of one per cent – effectively, as low as it can go
- In addition, the Bank has made a commitment to leave the rate there, conditional on the behaviour of inflation, until June 2010

Monetary Policy: Interest rates, global

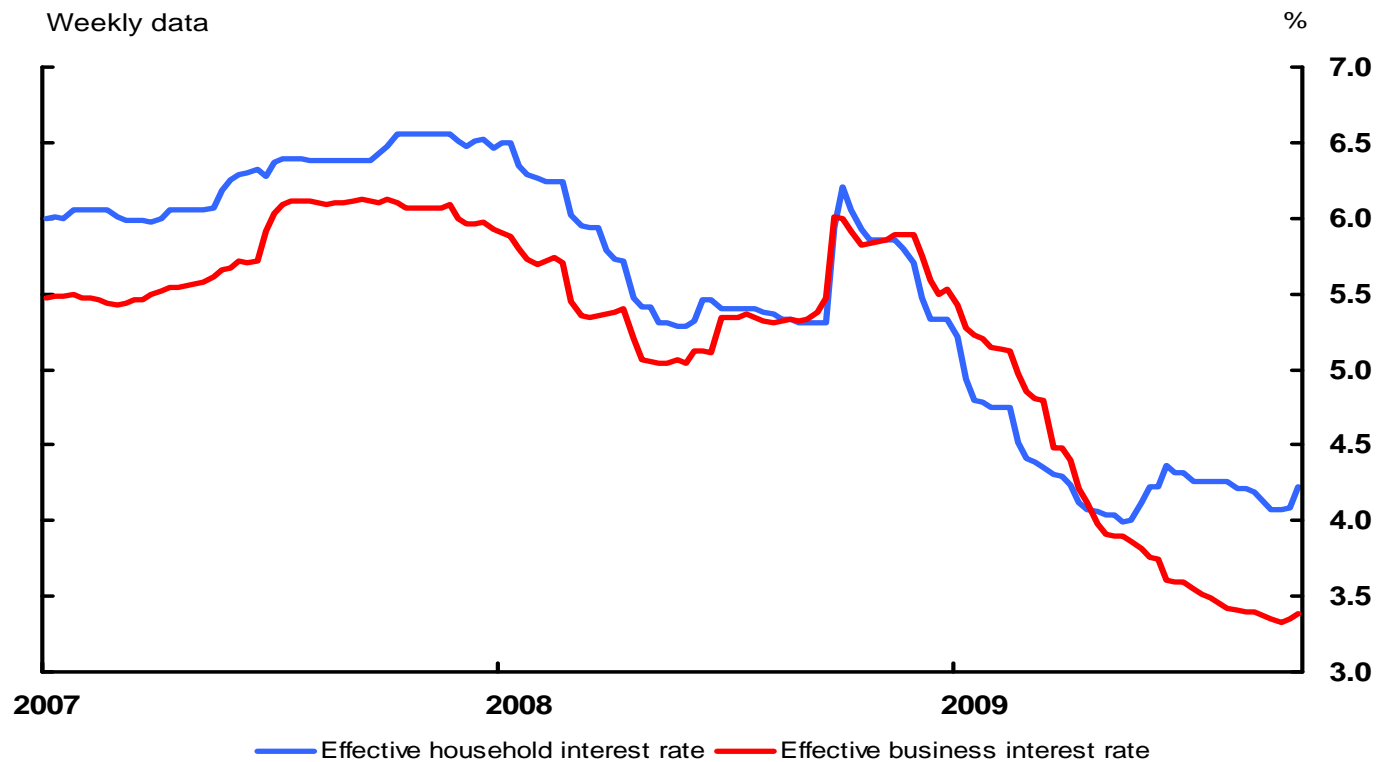
Policy rates have remained at historic lows in most countries



Sources: Bank of Canada, U.S. Federal Reserve, European Central Bank, and Bank of Japan

Monetary Policy: Interest rates in Canada

Borrowing costs for Canadian households and businesses remain very low



Note: For more information on these series, see <<http://credit.bankofcanada.ca/financialconditions>>.

Source: Bank of Canada calculations

Key Responsibilities: Monetary Policy

- Although the overnight rate is at its effective lower bound, the Bank retains considerable flexibility with regard to the conduct of monetary policy
- The Bank has three unconventional policy tools at its disposal, if necessary. They include: quantitative easing, credit easing, and conditional statements about the future direction of the key policy rate
- To date, only the last one -- conditional statements about the policy rate -- has been used

Key Responsibilities: Financial System

- The Bank promotes the stability and efficiency of the financial system, both in Canada and globally
- We work with other policy-makers, at home and abroad, to develop policies to sustain a stable and efficient financial system over time
 - Example: Coordinated response among G-20 members to the global crisis
 - Example: Since the onset of the global financial crisis, the Bank has provided considerable liquidity in various forms to the Canadian financial system

Key Responsibilities: Financial System

- As financial market conditions have improved, the demand for our special liquidity facilities has waned
- Of the three special facilities that the Bank of Canada has offered, two have recently been allowed to expire, since demand has fallen off
- And demand for the third -- the Bank's "workhorse" facility, the Term Purchase and Resale Agreements -- has also declined to the extent that auctions are now held biweekly rather than weekly, as in the past

Key Responsibilities: Financial System

- Like many other central banks in the aftermath of the global financial crisis, the Bank of Canada has been considering ways to strengthen financial regulation by adopting more of a “macroprudential” orientation -- that is, greater focus on the system as a whole
- We must always keep the big picture in mind, including the interdependencies among institutions and markets, when monitoring the financial system and assessing risks

Key Responsibilities: Currency

- Bank notes are one of the central bank's most tangible and popular products
- The Bank of Canada is responsible for ensuring that notes are readily accepted and secure from counterfeiting
- Our anti-counterfeiting goal: fewer than 50 counterfeits detected annually per million notes in circulation

Key Responsibilities: Currency

- Our anti-counterfeiting strategy:
 - Develop bank notes that are increasingly more difficult to counterfeit
 - Increase the routine verification of bank notes by retailers
 - Maintain the high quality of bank notes in circulation
 - Promote deterrence by law-enforcement officers and prosecutors
- Looking ahead, the Bank is currently developing Canada's next bank note series, expected to be introduced in late 2011

Key Responsibilities: Funds Management

- The Bank of Canada acts as the federal government's banker, fiscal agent, and adviser on funds management
- This includes managing Canada's foreign exchange reserves and the government's cash balances
- It also includes (in collaboration with the Department of Finance) management of the public debt, including Canada Savings Bonds

Key Responsibilities: Funds Management

- Managing the public debt is a particularly important task at present, given the additional debt financing associated with the extraordinary fiscal policy stimulus and the liquidity measures that have been recently undertaken
 - Example: Bank of Canada advice contributed to the design of the Insured Mortgage Purchase Program (IMPP), wherein the federal government, through Canada Mortgage and Housing Corporation (CMHC), has bought pools of insured mortgages, allowing increased mortgage lending

Transparency

Transparency and accountability underpin all of our work at the Bank of Canada

1. Monetary policy

- For monetary policy to work effectively, it is essential that Canadians understand and anticipate our policy actions and react accordingly
- The Bank contributes to this understanding by making our policy rate decisions eight times annually on a fixed schedule, issuing an explanatory press release each time
- The Bank issues quarterly *Monetary Policy Reports* to better explain our analysis and projections
- The Bank also releases the results of our quarterly *Business Outlook Survey* and *Senior Loan Officer Survey*

Transparency

2. Financial system

- In our *Financial System Review*, we regularly communicate our assessment of the key issues and vulnerabilities in the system, as well as our analysis of certain policy issues
- The Bank also provides clear information about our operations, such as the recent liquidity operations

3. Currency

- The Bank reports the actual number of counterfeit notes vis-à-vis our targets
- The Bank also communicates with the public and retailers about security features in our bank notes

Transparency

4. Funds management

- Transparency is critical in managing government funds and public money
- Via the Bank's website and our *Annual Report*, and through the Department of Finance website, we discuss the tools used, operations, and actions taken to manage the financial assets and outstanding stock of federal debt

Research

Leading-edge research is very important to the Bank

1. Monetary policy

- The Bank is in the midst of an intensive examination of whether the current inflation-control framework might be improved
- For the Bank's next inflation-targeting agreement with the federal government, which is scheduled to be renewed in 2011, the Bank is studying whether:
 - the 2 per cent target should be lowered
 - if the Bank should continue targeting the rate of inflation or, instead, the price level

Research

1. Monetary policy (cont'd)

- Research is also continuing into the challenges posed by policy rates that are near zero
- As well, the Bank is researching links between the real economy and the financial system

2. Financial system

- Research is under way on issues related to financial system efficiency, including price formation and liquidity in fixed-income markets and the impact of disclosure requirements on the cost of capital; and on the spread of electronic banking

Research

3. Currency

- Research is under way into the factors that influence choices in means of payments, including but not limited to bank notes
- This is important because changes in payment preferences can affect both the demand for bank notes and the overall efficiency of the retail payments system
- Another research project, in consultation with several other central banks, will provide data to model the characteristics of, and the motivations for, the choice of payment method

4. Funds management

- Work is continuing on a research program to better understand the trade-offs between risk and efficiency for payments and settlement systems



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Economic Outlook

Economic Outlook

- Recent indicators point to the start of a global recovery, following a deep, synchronous recession
- Following three quarters of sharp contraction, economic growth has also resumed in Canada
- The recovery is supported by monetary and fiscal stimulus, increased household wealth, improving financial conditions, stronger business and consumer confidence, beginning of recovery in the global economy, and strengthening terms of trade
- Global economic and financial developments have been slightly more favourable than was expected in July's *Monetary Policy Report*

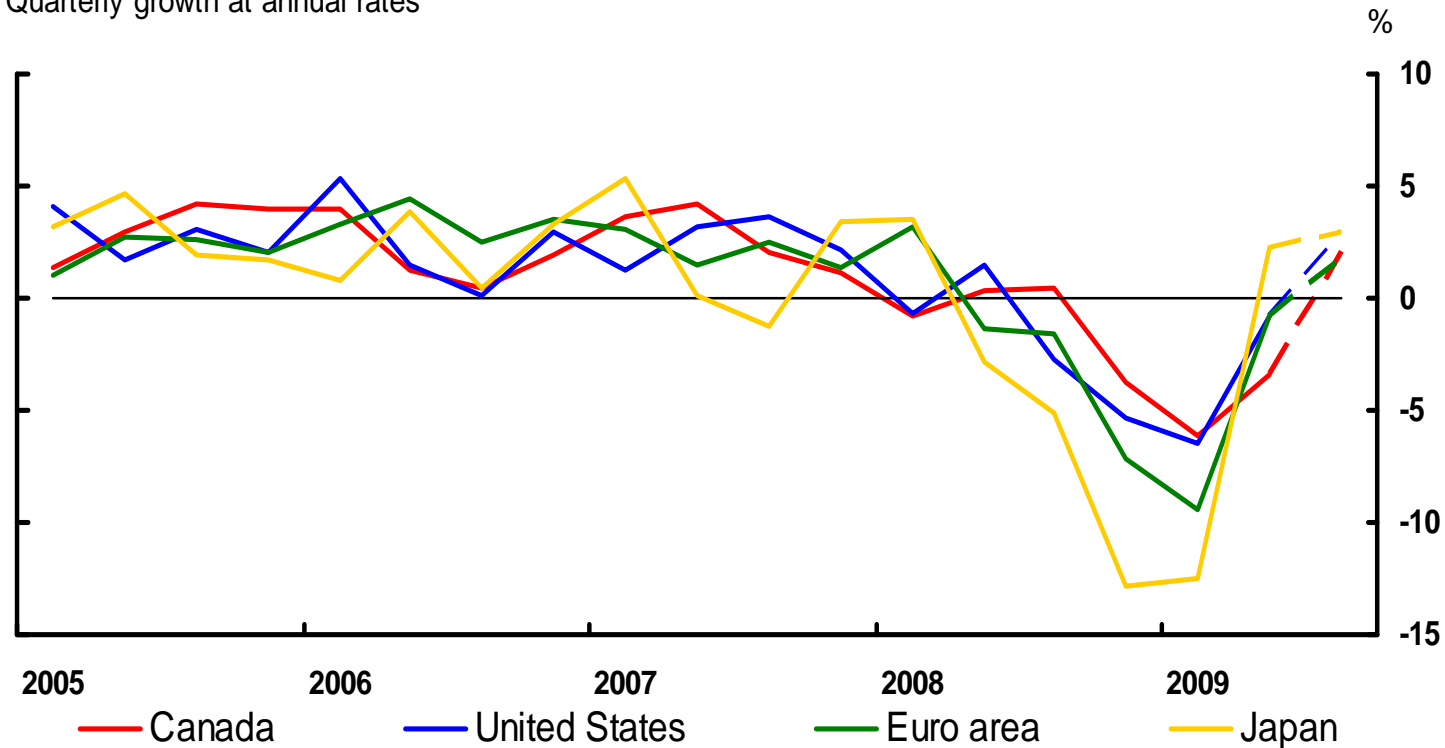
Economic Outlook

- But the increased volatility and persistent strength of the Canadian dollar are projected to more than offset the positive developments observed since July
- This will slow growth and dampen inflation pressures, delaying the return of inflation to the 2 per cent target
- The Canadian economy is projected to contract by 2.4 per cent this year and to grow by 3.0 per cent in 2010 and 3.3 per cent in 2011
- Inflation is expected to return to the 2 per cent target in the third quarter of 2011, one quarter later than was projected in July

Economic Outlook: Global Growth

Real GDP growth in major economies points to the start of a global recovery

Quarterly growth at annual rates



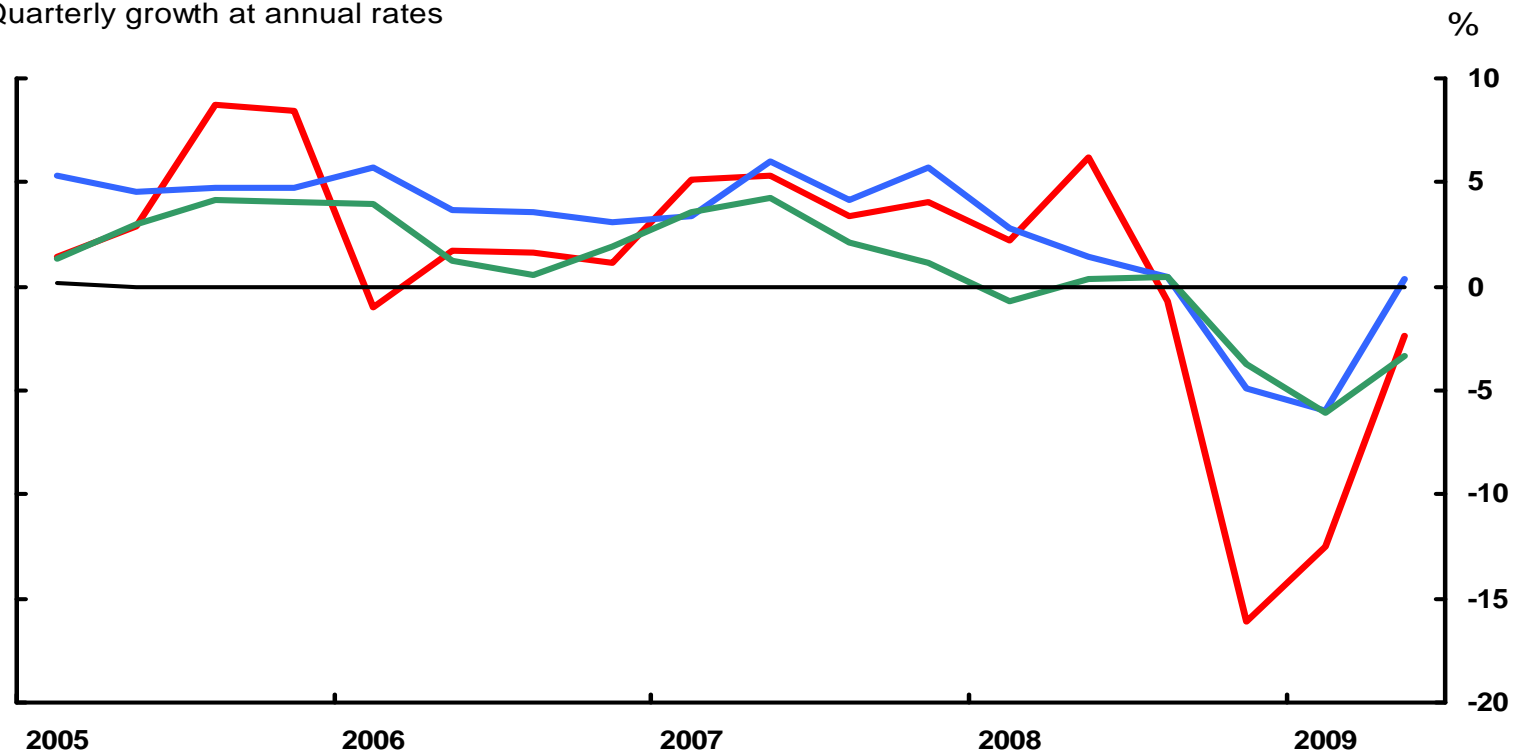
Note: The values for 2009Q3 are estimates.

Sources: Statistics Canada, U.S. Bureau of Economic Analysis, Eurostat, Japan Statistics Bureau, and Bank of Canada calculations.

Economic Outlook: Canadian Growth

Canadian real GDI has continued to fall in the second quarter, but by less than real GDP

Quarterly growth at annual rates



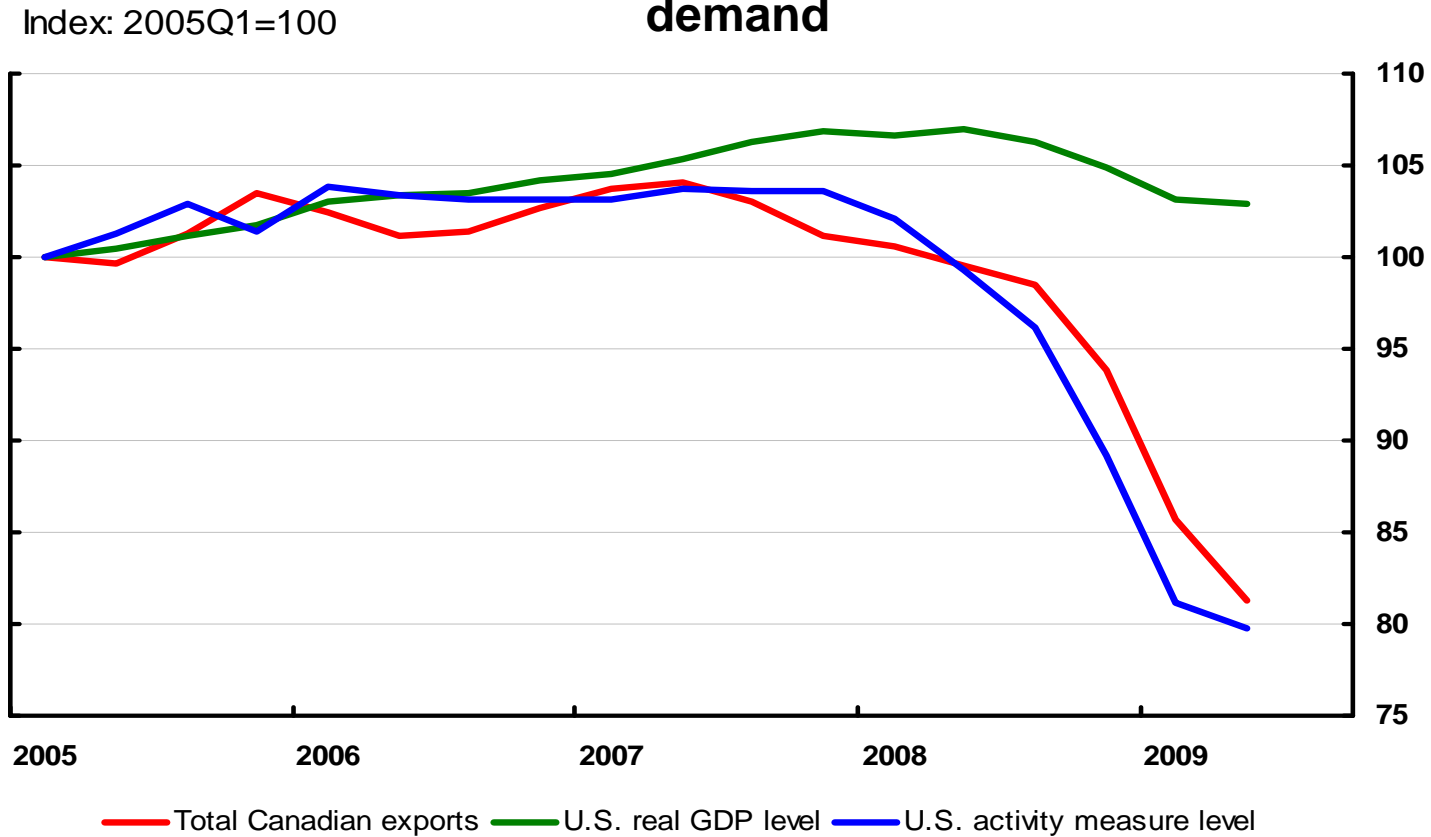
— Real gross domestic income^a — Real final domestic demand — Real gross domestic product

a. Real gross domestic income is current-dollar domestic product deflated by the price index for final domestic demand.

Sources: Statistics Canada and Bank of Canada calculations

Economic Outlook: Exports

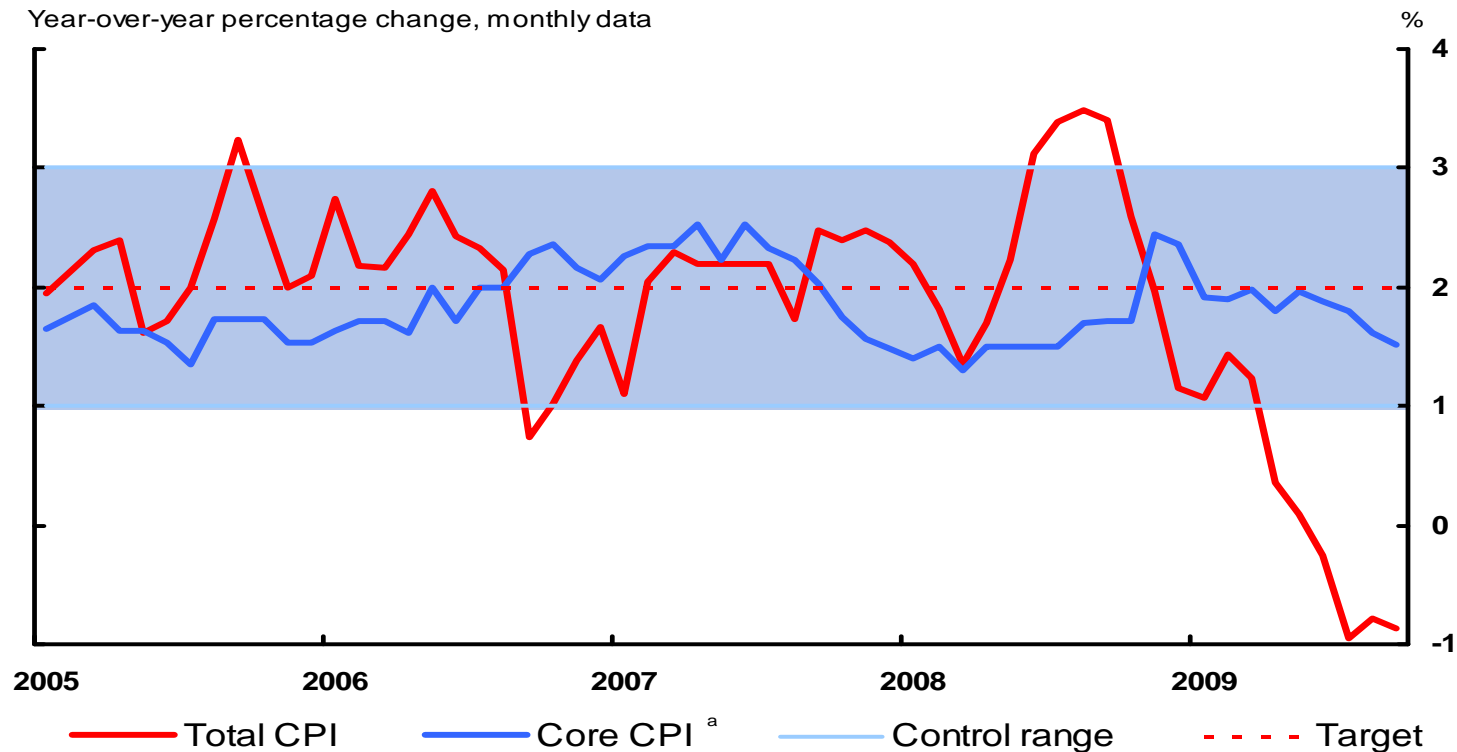
Canadian exports have plunged, largely owing to the weakness in U.S. demand



Sources: U.S. Bureau of Economic Analysis, U.S. Federal Reserve, Statistics Canada, and Bank of Canada calculations

Economic Outlook: Inflation

Total CPI inflation has troughed, and core inflation has declined

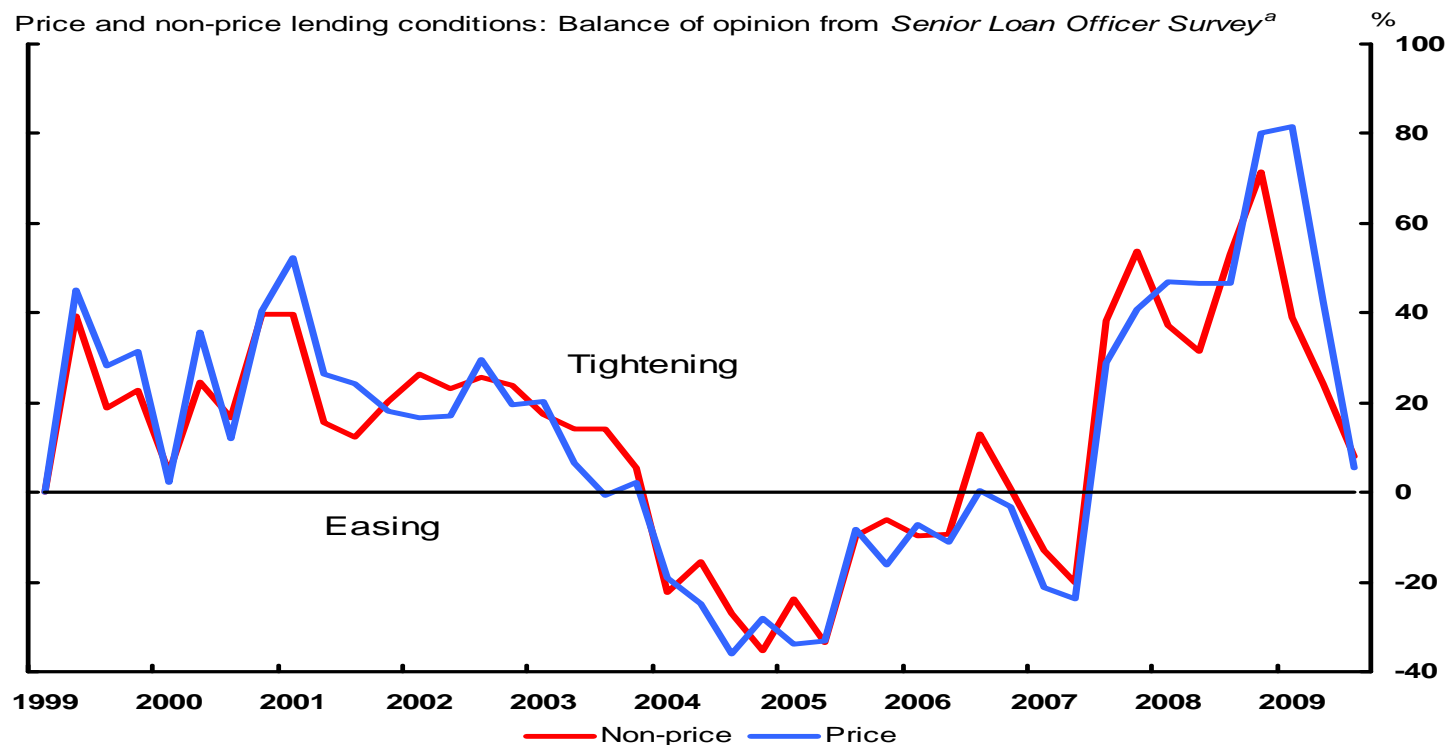


^a. CPI excluding eight of the most volatile components and the effect of changes in indirect taxes on the remaining components

Source: Statistics Canada

Economic Outlook: Credit Conditions

After a period of substantial tightening, credit conditions for businesses were little changed in the third quarter



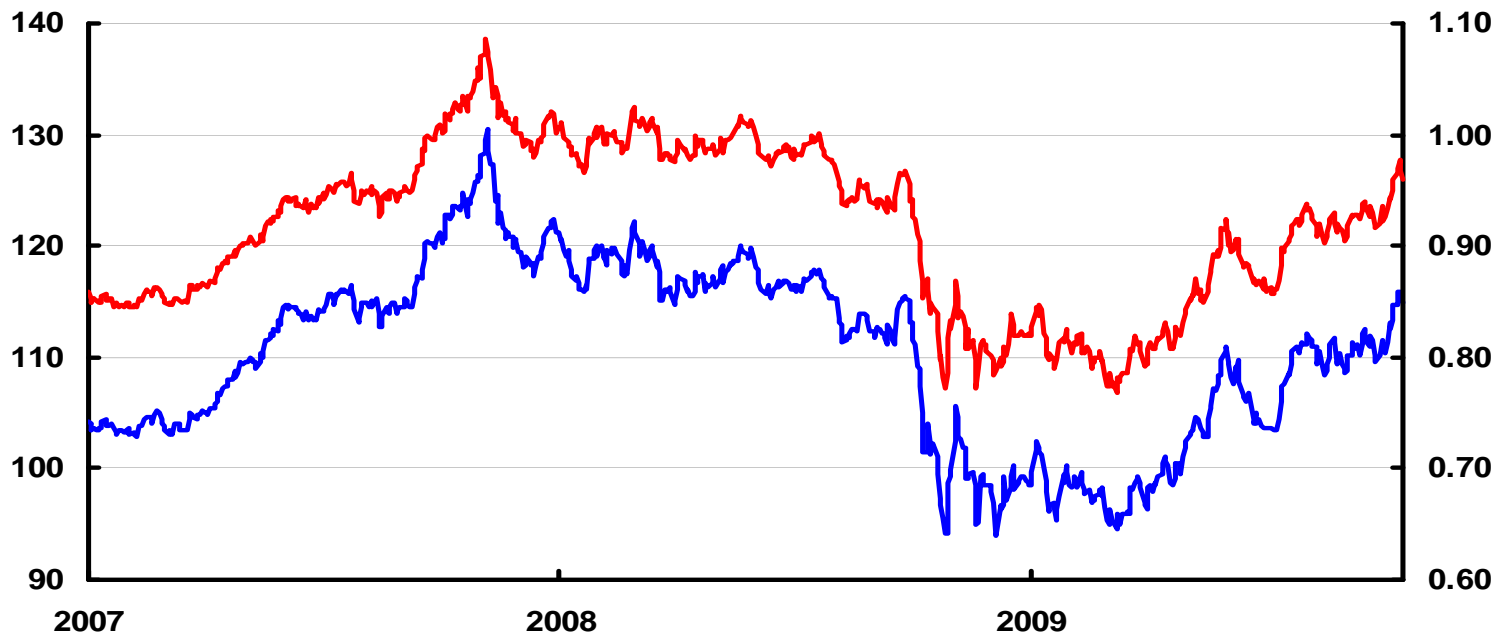
a. The balance of opinion is calculated as the weighted percentage of surveyed financial institutions reporting tightened credit conditions minus the weighted percentage reporting eased credit conditions. Note: Each series is the simple average of the balances of opinion for the small business, commercial, and corporate sectors. Source: Bank of Canada

Economic Outlook: Canadian Dollar

The Canadian dollar has appreciated sharply since the July Report

Daily data

US\$



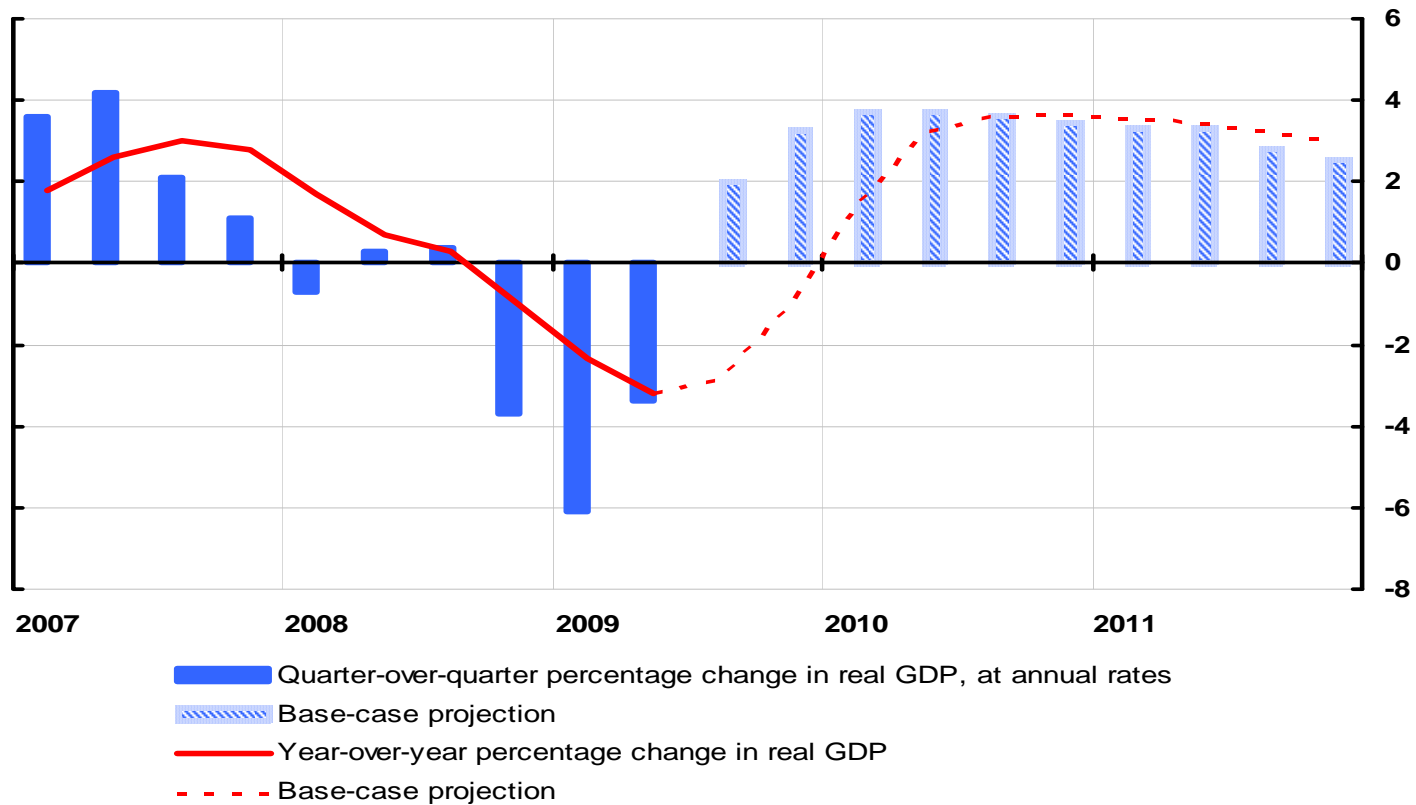
- CERI: Canadian-dollar trade-weighted index (against U.S. dollar, euro, yen, U.K. pound, Mexican peso, and Chinese renminbi) (left scale, 1992=100)
- Closing spot exchange rate for Canadian dollar vis-à-vis U.S. dollar (right scale)

Note: A rise in the index indicates an appreciation in the Canadian dollar.

Source: Bank of Canada

Economic Outlook: Canadian Future Growth

Real GDP growth is expected to rebound in the second half of 2009

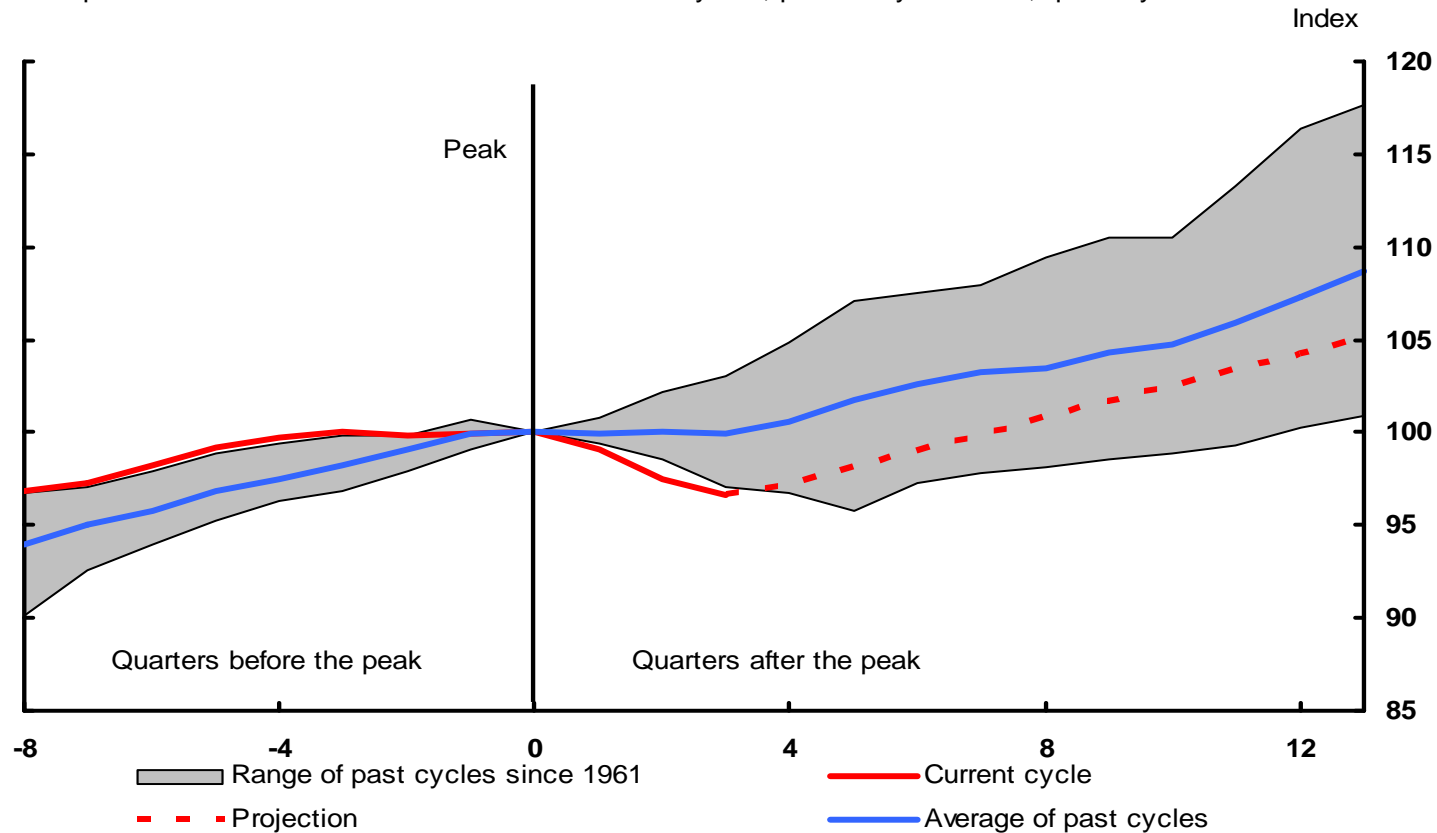


Sources: Statistics Canada and Bank of Canada calculations

Economic Outlook: Prospects for Recovery

The recovery in Canada should be more modest than in previous cycles

Comparison of Canadian real GDP across business cycles; peak of cycle = 100, quarterly data

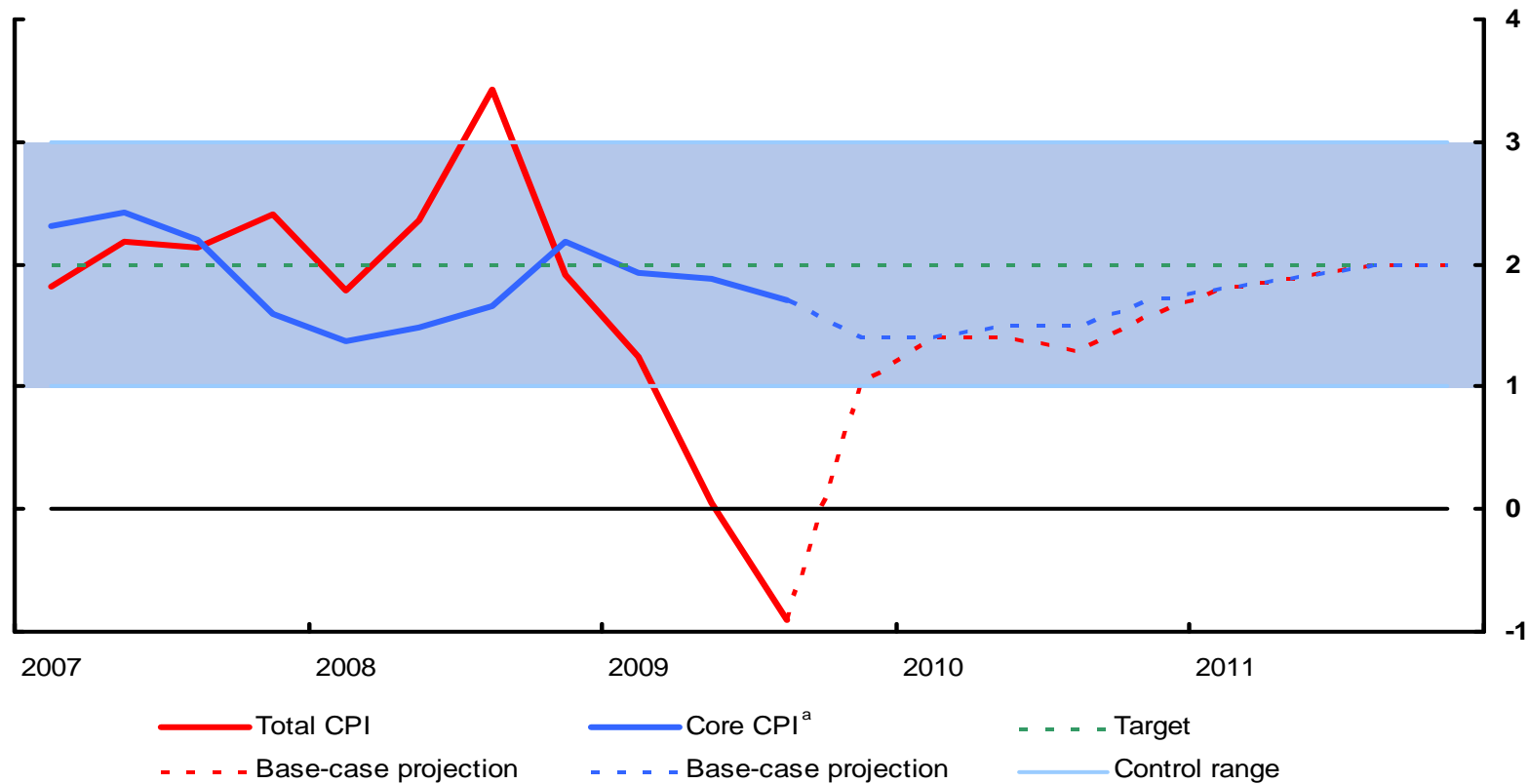


Sources: Statistics Canada and Bank of Canada calculations

Economic Outlook: Total and core inflation

Total and core inflation projected to return to 2% in Q3 2011

Year-over-year percentage change, quarterly data



^a: CPI excluding eight of the most volatile components and the effect of changes in indirect taxes on the remaining components

Sources: Statistics Canada and Bank of Canada calculations

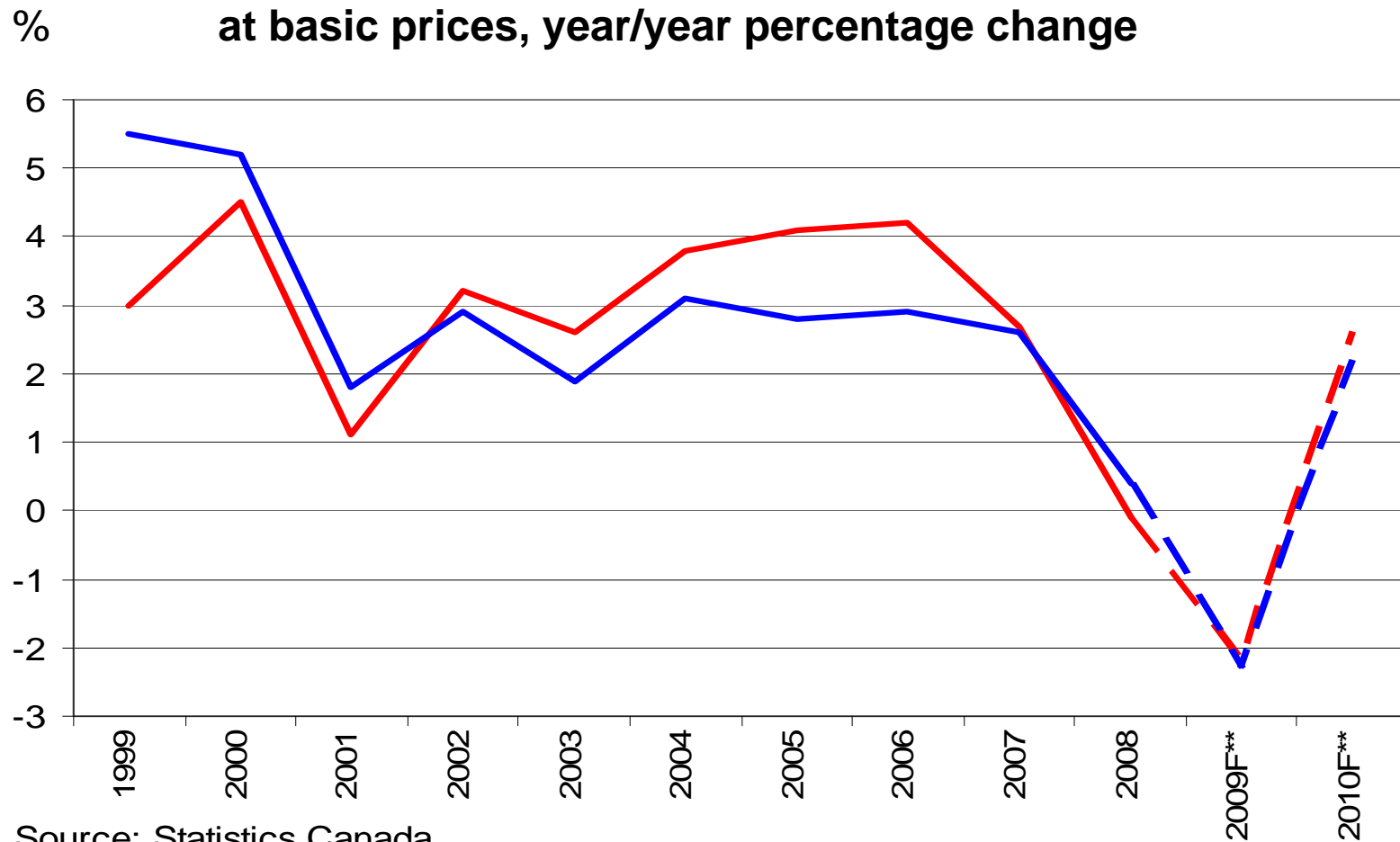
Economic Outlook: British Columbia

- Economic activity in British Columbia appears to be picking up after a very difficult year for virtually all areas of the B.C. economy
- The province's consumer confidence index fell to an historic low last December but has been on an upward trend since then
- Residential construction is picking up and demand for existing housing are improving
- Retail sales volumes are rising from earlier lows, although volumes are still below levels from one year earlier and are growing more slowly than in other regions

Economic Outlook: British Columbia

- Despite the completion of projects related to the 2010 Winter Olympics, major public sector spending on transportation and other infrastructure projects will continue to contribute to growth this year and in 2010
- However, export markets, especially in the United States, remain weak and are expected to strengthen only gradually
- A near-doubling of the unemployment rate over the past year indicates that considerable slack has developed in the labour market
- Bank of Canada surveys indicate that B.C. employers anticipate some job growth over the next year

Economic Outlook: B.C. growth in real GDP



Source: Statistics Canada

** Mean of private sector forecasts

— B.C. — Canada



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Conclusion

Conclusion

For further questions, please contact:

- Jock Finlayson, Director, Board of Directors, Bank of Canada
- John Murray, Deputy Governor, Bank of Canada

Or, Bank of Canada regional staff

- Farid Novin, Senior Regional Representative (Economics)
- Trevor Frers, Senior Regional Representative (Currency)