BANK OF CANADA

Opening Statement by
Gordon Thiessen
Governor of the Bank of Canada
before the Standing Senate Committee on
Banking, Trade and Commerce
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Mr. Chairman, I am pleased to appear before your Committee to provide an update on the economy and monetary policy, as well as to discuss with you other economic policy questions. Since we have recently tabled the Bank of Canada's Annual Report in Parliament, I would also be happy to answer any questions you may have about our stewardship of the Bank.

When we last met in November, a cloud of uncertainty hung over global financial markets and the world economy, although it appeared to be slowly lifting. At that time, I noted that the growth of the Canadian economy in 1999 would depend on how long the uncertainty lingered and how soon domestic financial markets stabilized. This was particularly important given that household and business confidence in Canada had been undermined by the heightened financial turbulence of last autumn.

I also suggested to you then that Canada was weathering the international crisis better than in the past because of the progress we had made in restructuring our private sector to become more competitive, in getting our fiscal house in order, and in keeping inflation low and stable.

Since November, the sky has become clearer, even though uncertainty persists in a number of areas. Interest rate reductions in the United States last autumn and in other industrial countries since then have helped to calm international markets and support economic activity. The most recent cuts occurred in early April -- 50 basis points by the European Central Bank and 25 basis points by the Bank of England.

These latest interest rate reductions should help to support confidence and domestic spending throughout Europe, and are a positive element for the international economy more generally.

As well, there has been some firming in commodity prices in the first quarter of this year.

Perhaps the most important positive external development from a Canadian perspective has been the remarkable performance of the U.S. economy. That economy ended 1998 on a much stronger note than expected. And because of that, the level and momentum of U.S. economic activity in early 1999 is greater than most forecasters had predicted.

The Canadian economy also regained vigour in the fourth quarter of 1998. Although this partly reflected the rebound from labour disruptions in the previous quarter, surging exports were the main factor behind the pickup in activity. And there was particularly strong employment growth in the closing months of 1998. With this and greater financial stability contributing to improved consumer confidence, all indications are that the Canadian economy has continued to expand at a healthy pace in the first part of 1999.

Inflation in Canada has been fluctuating around the bottom of the Bank's target range of 1 to 3 per cent. This low rate of inflation and increased stability in financial markets prompted the Bank to reduce interest rates on four occasions between September and March. These reductions completely reverse the one percentage point increase in the Bank Rate that was needed to bolster investor confidence last August, in the wake of heightened global financial volatility.

As we look forward, the ongoing strength of the U.S. economy and the low level of the Canadian dollar should continue to underpin growth in our exports. And more stable financial markets and accommodative monetary conditions should support increased spending by Canadian households and businesses. However, the economic stagnation in Japan and some lingering uncertainty in Latin America, associated with the financial problems Brazil is coping with, are constraining world economic activity and the recovery of those primary commodity markets that are important to Canada.

Still, all in all, while uncertainties remain, the outlook for the world economy and for Canada is more positive than it was last November.

Mr. Chairman, I know that with the recent successful launch of the euro as a common currency for the 11 countries participating in the European Economic and Monetary Union, your Committee has been discussing alternative exchange rate regimes. I will be happy to respond to your questions on this issue, but perhaps it would be useful if I briefly restated the views I have already expressed publicly.

The smooth introduction of the euro has, no doubt, been a major political, administrative, and technical achievement. However, the euro does not provide a blueprint for a North American monetary union. There are no parallels here to the profound political forces that have been behind the move to greater integration in Europe over the past 50 years.

Unlike the euro zone, which encompasses three large countries and eight other medium- and smaller-sized participants, any North American monetary arrangement would surely mean that Canada would have to adopt the U.S. currency.

Moreover, our present flexible exchange rate regime plays an important role in helping us adjust to economic shocks that affect Canada differently than the United States. The most important shocks of this character have been fluctuations in primary commodity prices.

The marked decline in commodity prices over the last two years has meant that Canada as a whole is relatively less well off. That is a reality we have to face, and adjust to, no matter what currency regime is in place. If the exchange rate for the Canadian dollar is allowed to move in response to this reality, the adjustment process is smoother and faster. Without exchange rate flexibility, the adjustment would have to take place primarily through declines in wages and prices, which would cost us more in terms of output and employment losses.

There is a tendency in Canada to blame movements in the Canadian dollar as the cause of economic problems. The fact is that currency movements are a consequence of such problems, <u>not</u> a cause. In my assessment, Mr. Chairman, our flexible exchange rate regime is serving Canada well.