



BANK OF CANADA
BANQUE DU CANADA

CELEBRATING 75 YEARS
CÉLÉBRONS 75 ANS

Promoting Canada's Economic and Financial Welfare

Remarks to the Lévis Chamber of Commerce

Lévis, Quebec

8 February 2010



Pierre Duguay
Deputy Governor



Mandate

The Bank of Canada’s mandate, as set out in the Bank of Canada Act, is:

- “to regulate credit and currency in the best interests of the economic life of the nation... and generally to promote the economic and financial welfare of Canada....”
- “....so far as may be possible within the scope of monetary action....”

Mandate

We do this by:

- aiming to keep inflation low, stable, and predictable
- promoting a stable and efficient financial system
- supplying secure, quality bank notes
- providing efficient banking services to the government and to financial institutions



Key Responsibilities

Four core functions:

- Monetary policy
- Financial system
- Currency
- Funds management

One consistent approach:

- A clear objective
- A medium-term perspective
- Accountability for our actions



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Monetary Policy

Our objective: Keep inflation low, stable, and predictable

- reduces uncertainty and helps businesses, consumers make decisions with greater confidence
- dampens the business cycle by causing monetary policy to act as a countercyclical influence
- Inflation target set under an agreement with the federal government, reviewed every five years



Monetary Policy

The Bank achieves the 2 per cent inflation target by adjusting its target for the overnight interest rate

- That, in turn, influences other interest rates, exchange rate, and, ultimately, overall demand for Canadian goods and services
- Policy actions can take up to two years to have their full effect on inflation
- Therefore, the Bank always looks ahead to future inflation
- Bank's approach to inflation target is symmetrical



Monetary Policy

Monetary policy is more effective when Canadians understand what the Bank is doing and act accordingly

- To foster understanding,
 - policy rate decisions announced eight times a year on a fixed schedule,
 - accompanied by supporting analysis of economic developments and projections of inflation
 - analysis elaborated on in quarterly *Monetary Policy Report*
- Communications focus on medium-term perspective of monetary policy



Monetary Policy

Global financial crisis:

In reaction to the crisis and consequent recession, the Bank of Canada:

- reduced the target for the Bank's overnight rate to one-quarter of one per cent – as low as effectively possible
- committed to leave the rate there until the end of June 2010, conditional on the behaviour of inflation
- articulated a strategy to provide further monetary stimulus through quantitative easing and credit easing **if needed** (the need has not materialized)



Financial System

Our objective: To promote the stability and efficiency of the financial system, in Canada and globally

Canada's financial system consists of:

- financial institutions, e.g., banks, caisses populaires, insurance companies
- financial markets, including securities and foreign exchange markets
- clearing and settlement arrangements



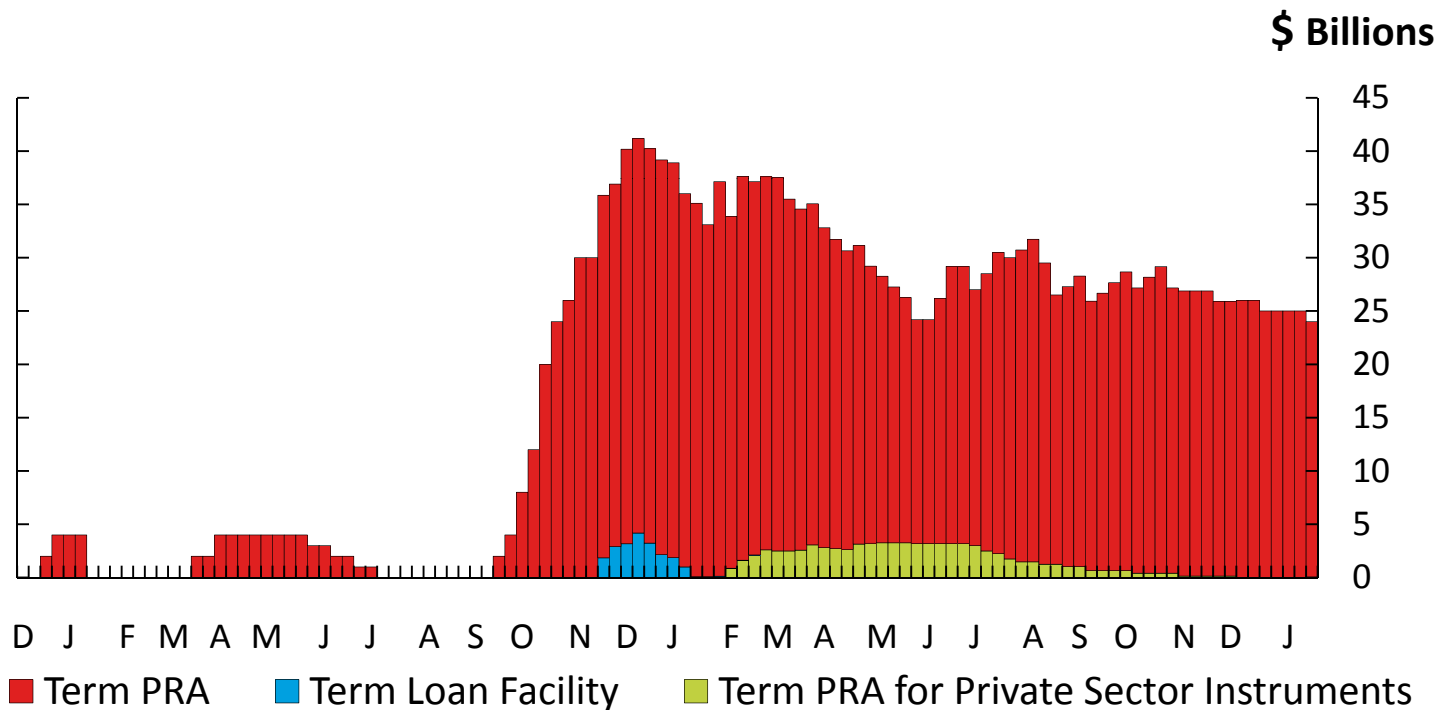
Financial System

The Bank achieves its objective by:

- providing adequate liquidity to support the stable functioning of the financial system
- overseeing clearing and settlement systems to prevent risk contagion
- encouraging the development of key financial markets
- assessing risk and vulnerabilities in the financial system
- publishing informative research and analyses in the Bank's *Financial System Review*
- working with other domestic and international policy makers (e.g. FISC, HoA, FSB...)

The Bank massively expanded its liquidity provisions to support the functioning of the financial system when markets froze

Weekly Par Value Outstanding at Bank of Canada Facilities



December 2007 – January 2010

Source: Bank of Canada



Financial System

The global financial crisis has brought increased attention on the system as a whole

- interdependencies among institutions and markets
- need for key funding markets to remain open
- system-wide approach to regulation
 - shared responsibility of Department of Finance and federal financial regulatory authorities (including Bank of Canada)
 - ultimate responsibility rests with Minister of Finance
- G-20 leaders have announced plans for major reforms of global financial system



Currency

Our objective: Meet the needs of Canadians for reliable bank notes – readily accepted, secure from counterfeiting

- Bank's anti-counterfeiting goal: fewer than 50 counterfeits detected annually per million notes in circulation
- currency is distributed through financial institutions
- the Bank's regional offices oversee distribution system and deliver currency education programs to law enforcement, financial institutions, and retailers
- rising demand for bank notes, a source of rising revenues to the Bank (and the government)



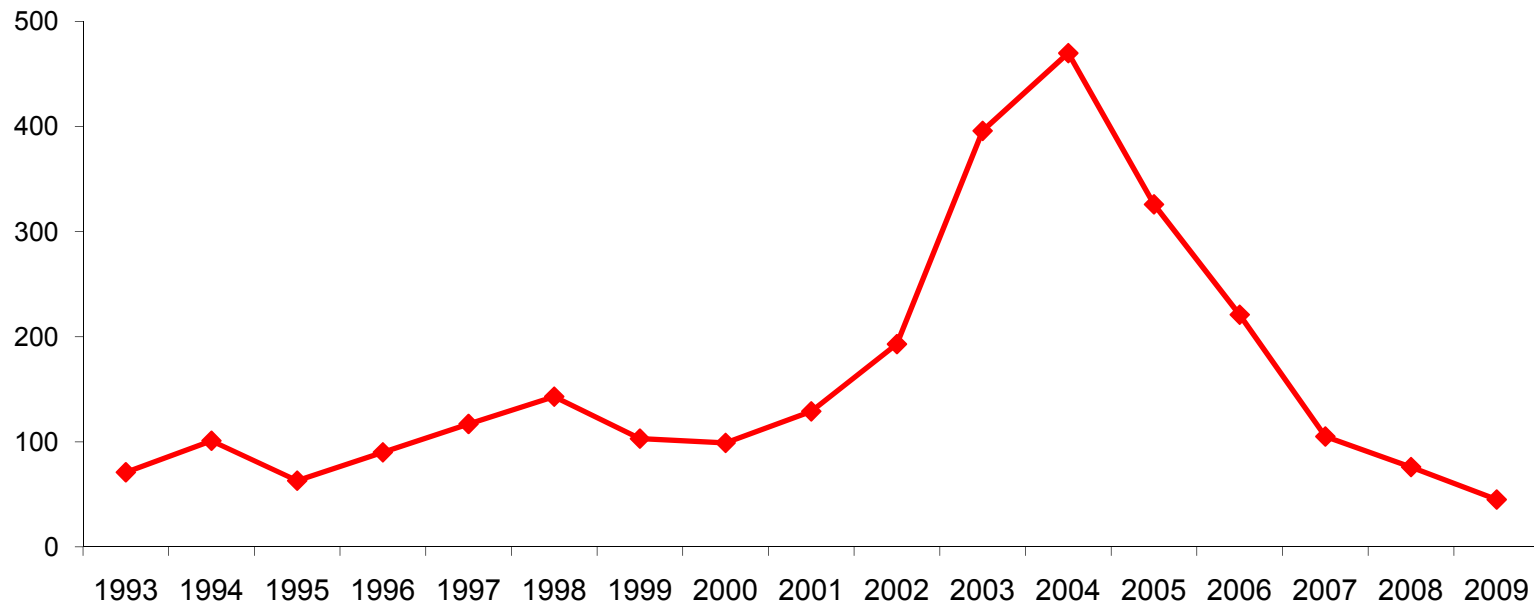
Currency

- Bank's strategy to maintain confidence in bank notes:
 - 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 counterfeit deterrence by law-enforcement officers and prosecutors
- Currently developing Canada's next bank note series, expected to be introduced in late 2011 (*latest design, using state-of-the-art anti-counterfeiting technology launched in 2004*)



The Bank's strategy has been effective in reversing a surge in counterfeiting from 2001 to 2004

Counterfeit Canadian bank notes detected annually for each one million genuine notes in circulation





Funds Management

Our objective: To provide effective banking services to the federal government and key financial system players. This involves:

- managing Canada's foreign exchange reserves and federal government's cash balance
- managing the public debt in collaboration with the Department of Finance
- administering Canada Savings Bonds program
- providing the means of final settlement of daily flows of payment among financial institutions *[In 2009, the LVTS processed on average over 22,000 payments a day, worth over \$150 billion]*



Research

Leading-edge research is very important to the Bank

The Bank is currently studying:

- possible improvements to the current inflation-control framework
- linkages between the real economy and the financial system
- better ways to assess financial system risks
- factors influencing means of payment choices, including bank notes
- trade-offs between risk and efficiency for payments and settlement systems

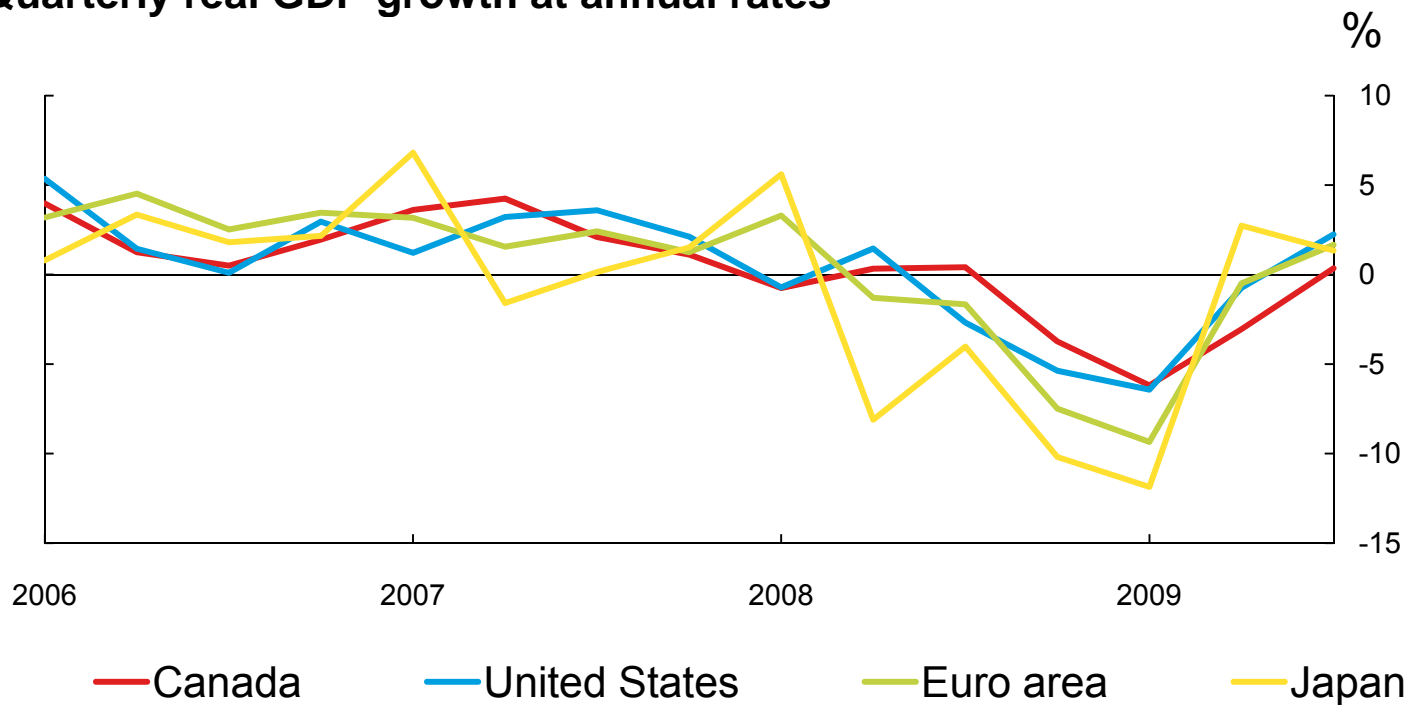
Economic Outlook





The world economy is emerging from the most severe crisis since the Great Depression

Quarterly real GDP growth at annual rates

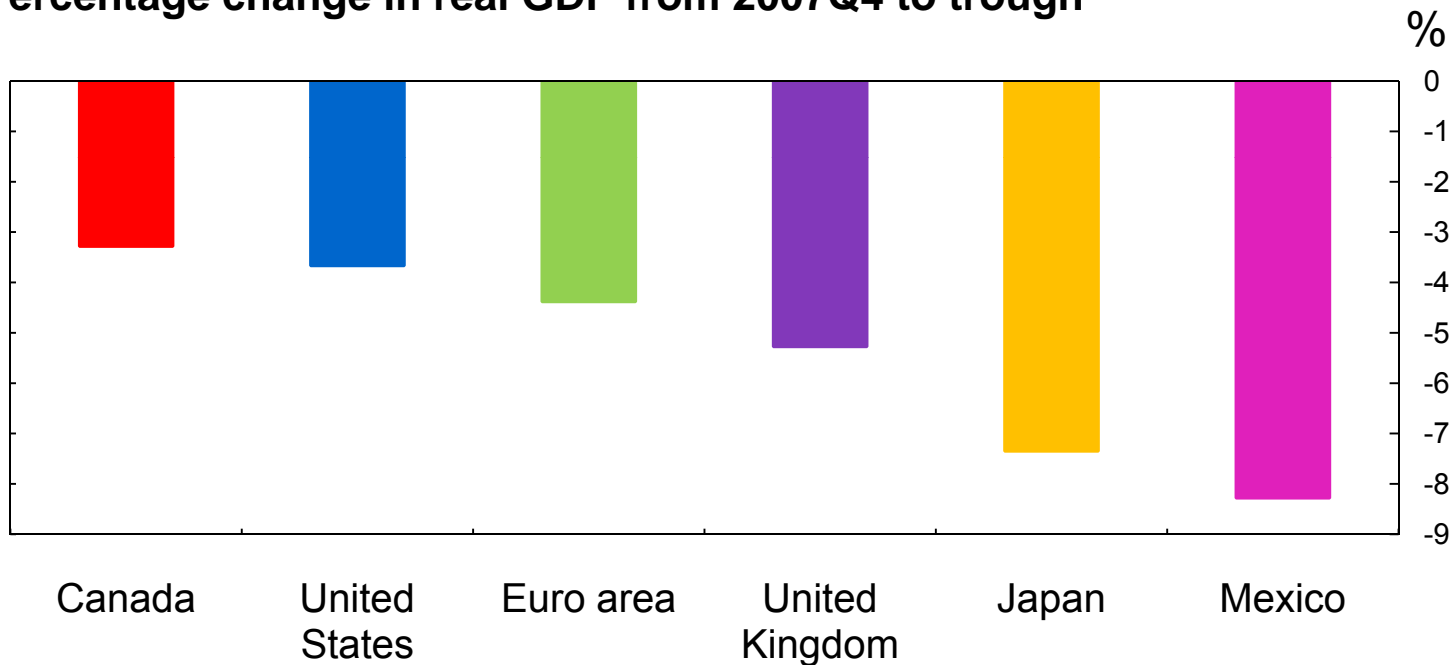


Sources: Statistics Canada, U.S. Bureau of Economic Analysis, Eurostat, and Japan Statistics Bureau.



Economic downturn less severe in Canada than elsewhere, in part because of Canada's sound banking system, strong household and business balance sheets, and timely policy response

Percentage change in real GDP from 2007Q4 to trough ^a

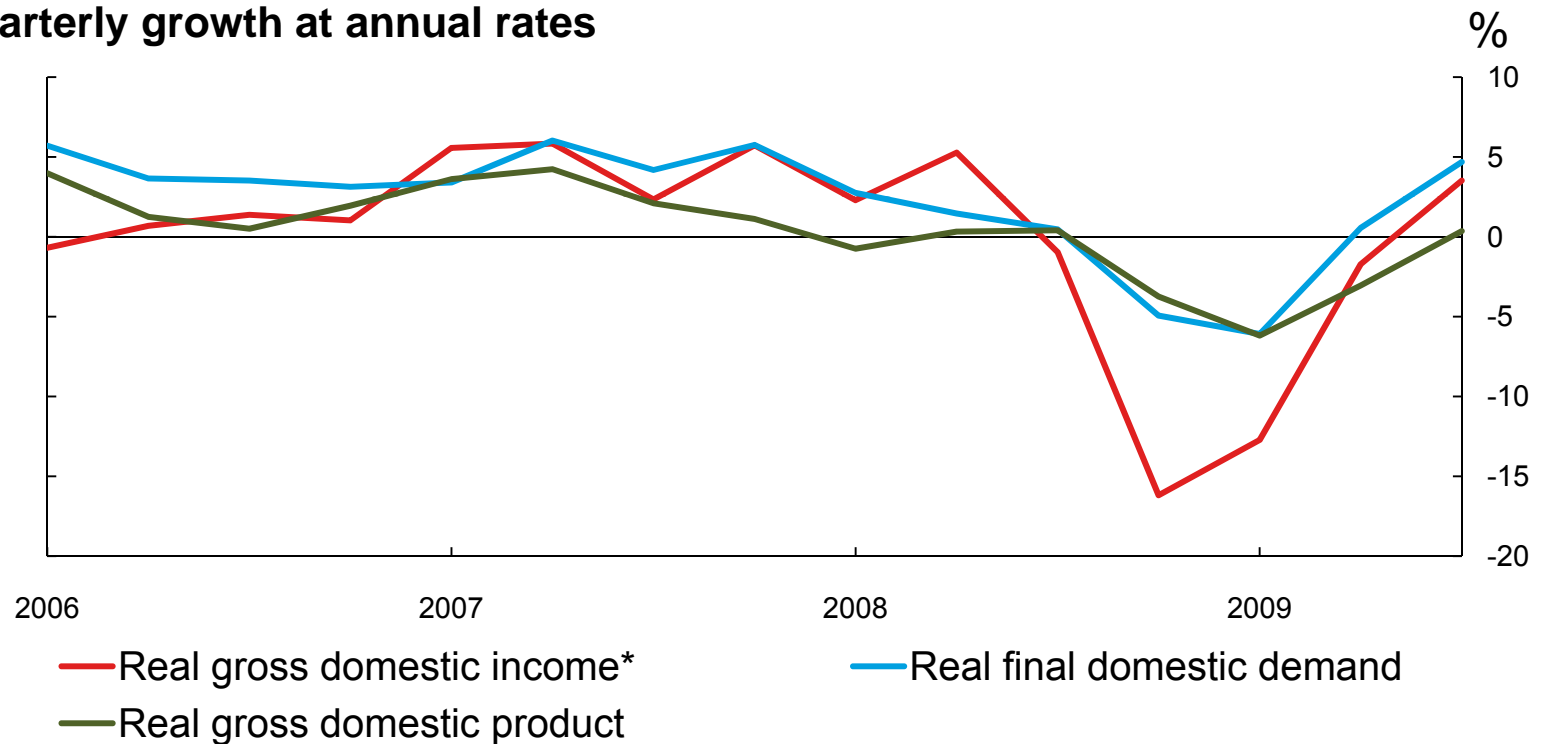


a. 2007Q4 corresponds to the start of the recession in the United States (based on NBER).
Sources: OECD, Bank of Canada calculations



Recovery is under way in Canada, where final domestic demand and real domestic income increased sharply in the third quarter of 2009

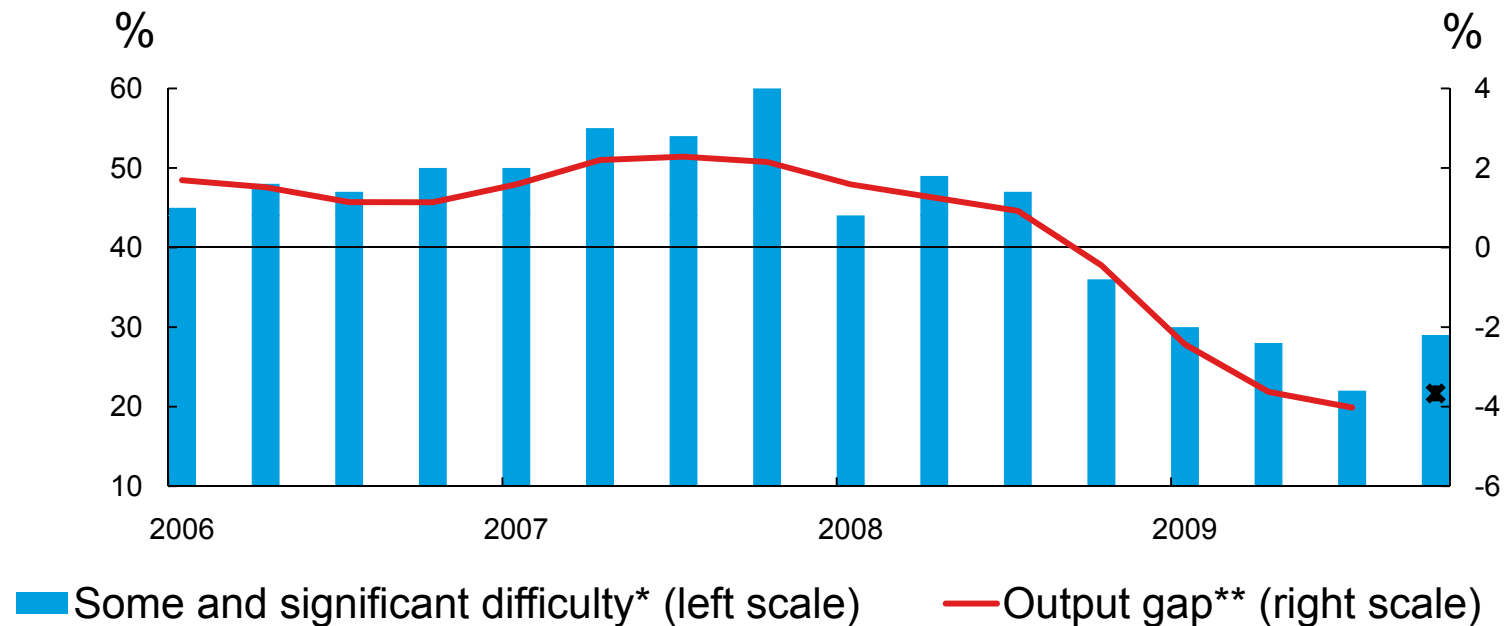
Quarterly growth at annual rates



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

Source: Statistics Canada

Nonetheless, there remains considerable excess supply in the Canadian economy



* Response to survey. Percentage of firms indicating that they would have either some or significant difficulty meeting an unanticipated increase in demand/sales.

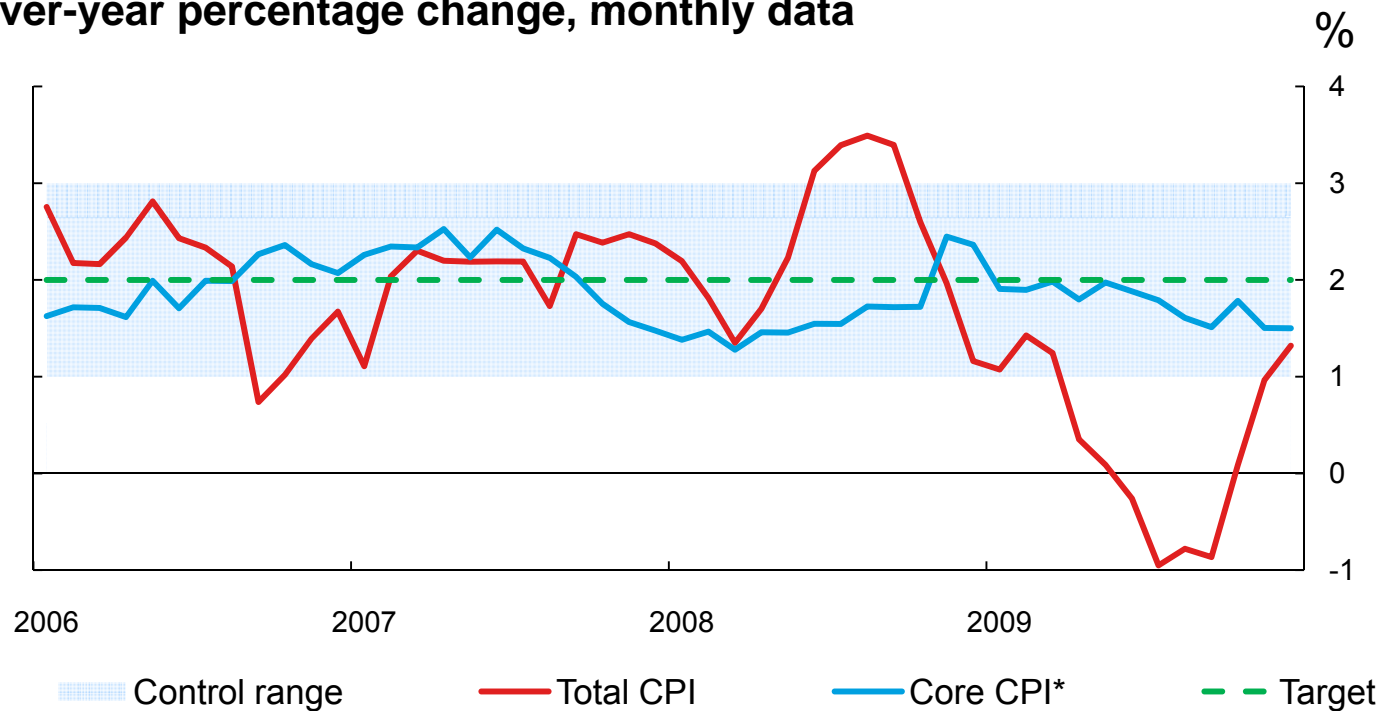
**Difference between actual output and estimated potential output. The estimate for the fourth quarter of 2009 (indicated by X) is based on a projected increase in output of 3.3 per cent (at annual rates) for the quarter.

Source: Bank of Canada



Total and core CPI inflation both remain below 2 per cent

Year-over-year percentage change, monthly data



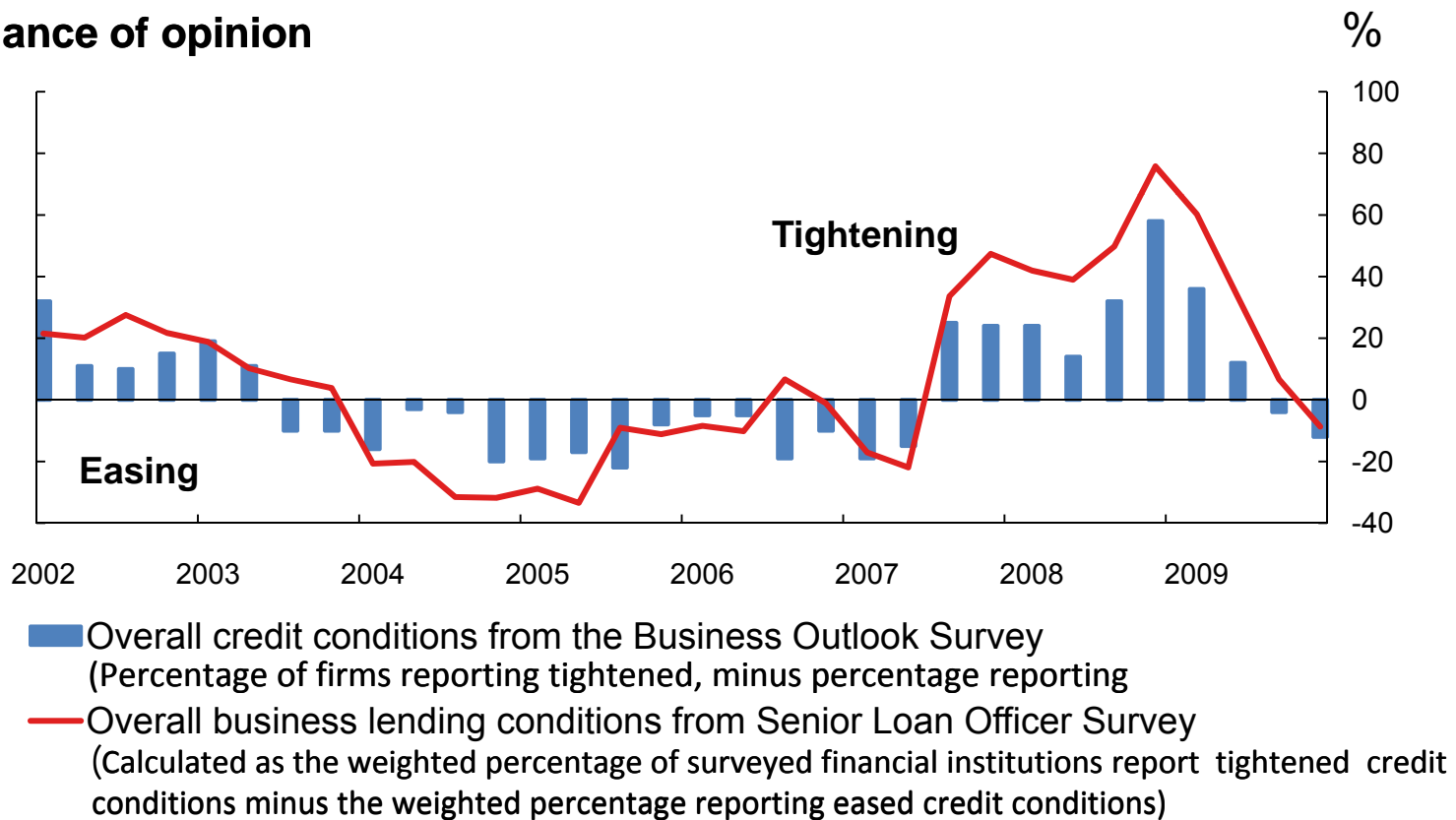
•CPI excluding eight of the most volatile components and the effect of changes in indirect taxes on the remaining components

Source: Statistics Canada



Survey results suggest that lending conditions for Canadian businesses have started to improve following a period of substantial tightening...although small business are still experiencing some modest further tightening

Balance of opinion

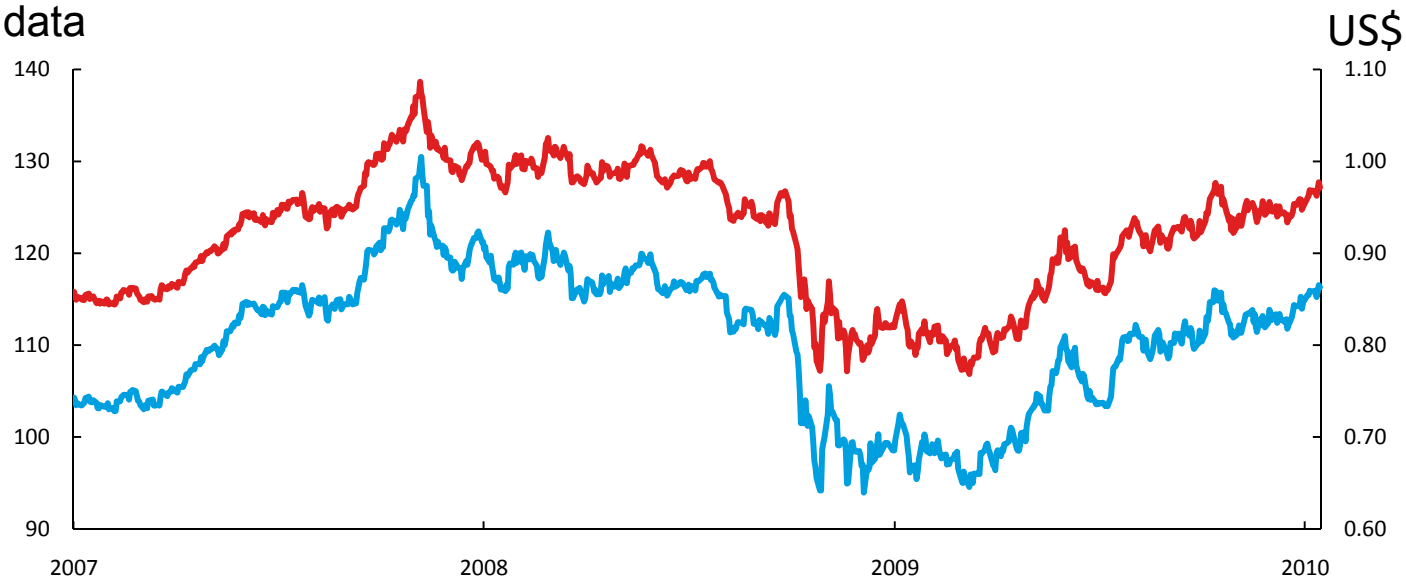


Source: Bank of Canada



The strength of the C\$ and the low absolute level of U.S. demand will continue to act as significant drags on economic activity

Daily data



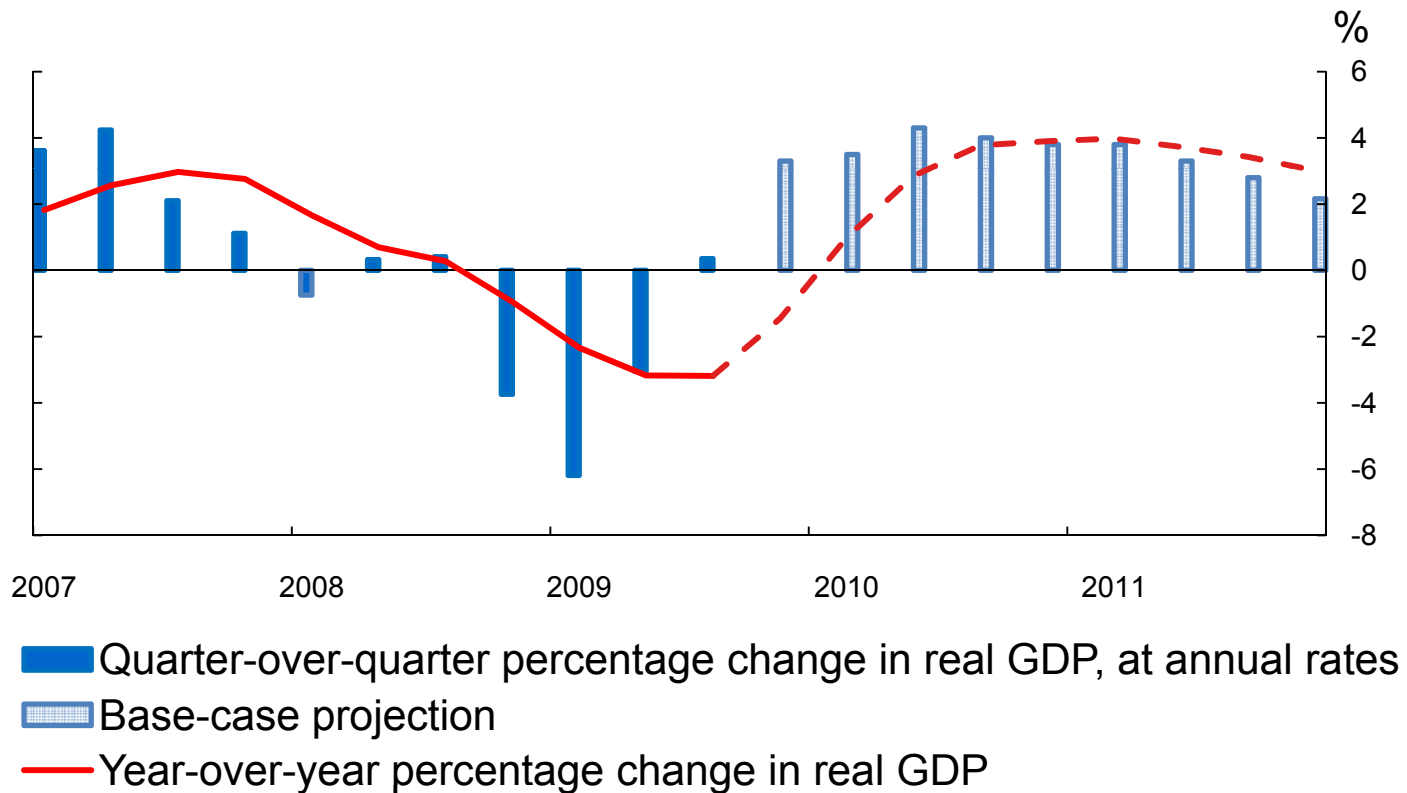
- CERI: Canadian-dollar trade-weighted index (against U.S. dollar, euro, yen, U.K. pound, Mexican peso, and Chinese renminbi) (left scale, 1992 = 100)
- Closing spot exchange rate for Canadian dollar vis-à-vis U.S. dollar (right scale)

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

Source: Bank of Canada



Real GDP growth is expected to accelerate in 2010. The Canadian economy is projected to grow by 2.9 per cent in 2010 and 3.5 per cent in 2011, after having contracted by 2.5 per cent in 2009.

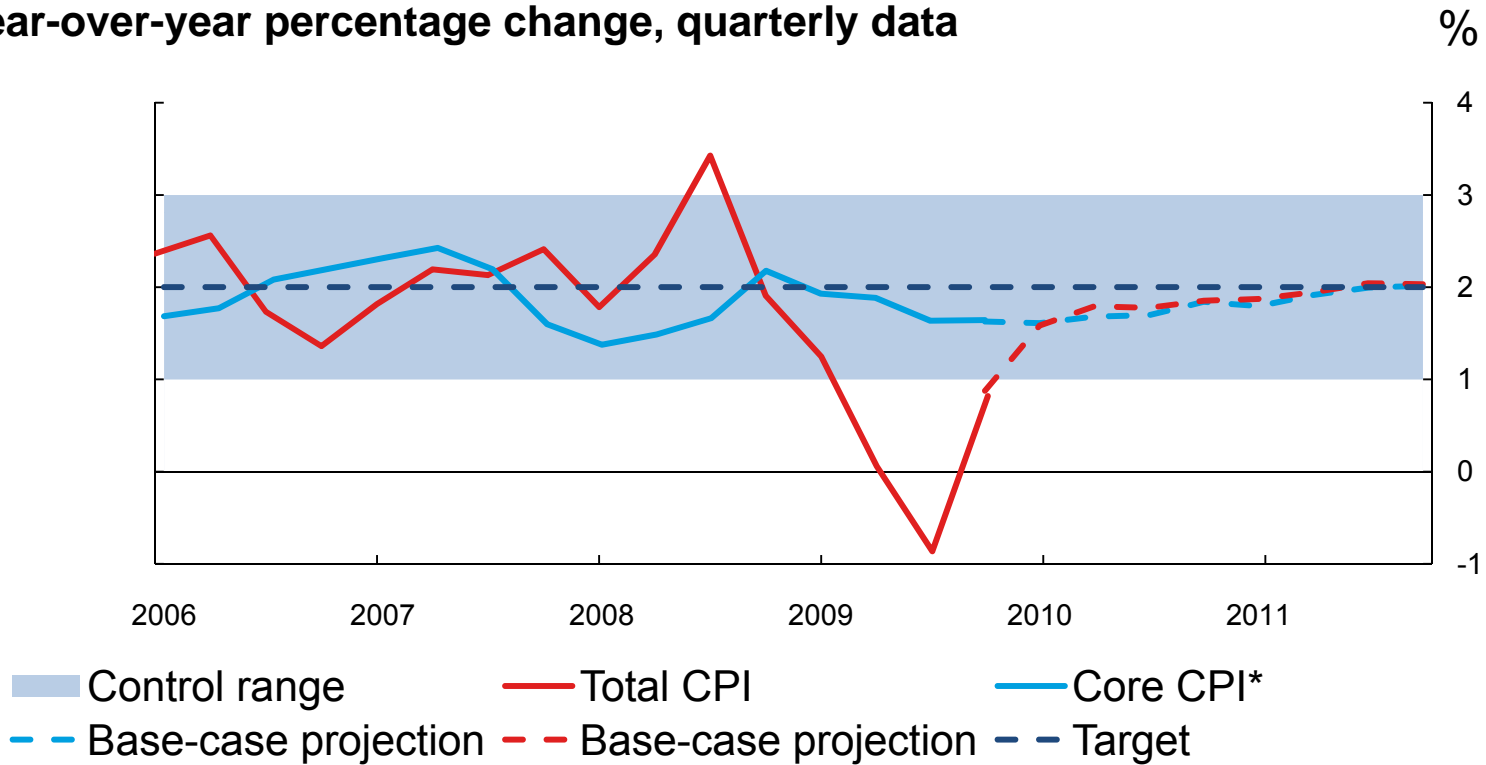


Sources: Statistics Canada and Bank of Canada calculations



Total and core CPI inflation are projected to return to 2 per cent in the third quarter of 2011, as the Canadian economy returns to full capacity

Year-over-year percentage change, quarterly data



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

Source: Statistics Canada and Bank of Canada calculations



Risks to the Outlook

- The factors shaping the recovery are: policy support, increased confidence, improving financial conditions, global growth, and higher terms of trade
- There are both upside and downside risks to the outlook for inflation:
 - the global recovery could be more vigorous or more protracted than projected
 - Canadian domestic demand could be more robust than projected, but persistent strength in the Canadian dollar could act as a further drag on growth and put downward pressure on inflation
- Risks have diminished, but remain elevated



Implications for Monetary Policy

- On 19 January, the Bank reaffirmed its conditional commitment to hold its policy rate at $\frac{1}{4}$ per cent until mid-2010 in order to achieve its inflation target
- The Bank also reiterated that it retains considerable flexibility to conduct monetary policy at very low interest rates, consistent with the framework outlined in the April 2009 *Monetary Policy Report*
- Nonetheless, the overall risks to the inflation projection are tilted slightly to the downside as a result of monetary policy operating at the effective lower bound



Quebec Economy

- Recession milder in Quebec than in the rest of Canada
 - 2.5% fall in output in Quebec versus 3.3% for Canada
- Attributable to:
 - Provincial infrastructure program announced in 2007 and projects ready to start when recession began
 - Business restructuring effected before 2008
 - Smaller impact from downturn in the automotive sector
 - More stable house prices, so less damage to consumer confidence
- Economic growth resumed in third quarter 2009, likely strengthened in the fourth quarter



Thank you



For further questions, please contact:

- David Laidley, Director, Board of Directors, Bank of Canada
- Pierre Duguay, Deputy Governor, Bank of Canada
- Or, Bank of Canada regional staff
 - Michael Yake, economic representative
 - Phuong Anh Ho Huu, currency representative