Recent Developments: An Update to the *Monetary Policy Report*

The outlook for the world economy and for Canada has not changed significantly since the May 1999 *Monetary Policy Report*. Recent developments, however, have imparted a firmer tone to a generally positive scenario.

Conditions in emerging-market economies have improved, and in some of the Southeast Asian countries most affected by the recent financial crisis, prospects are good for a turnaround this year and next. Overall, the situation in Latin America has also been better than expected, partly because of Brazil's efforts to address its financial difficulties.

In the United States, aggregate demand continues to expand at rates that are above the growth of potential, increasingly pressing against the economy's capacity limits, and thus rekindling concerns about nascent inflationary pressures. In the circumstances, and given the easing of financial strains that had prompted the reduction in interest rates last autumn, the U.S. Federal Reserve raised its target rate for federal funds by 25 basis points at the end of June to help maintain sustainable economic expansion.

More recently, there have also been tentative signs of an improvement in economic conditions in some of Canada's other major overseas trading partners. In Japan, national accounts data for the first quarter show an apparent sharp upturn in output. At this time, however, it is difficult to ascertain the extent and durability of the rebound or whether it signals the beginning of a sustained recovery. In Europe, growth has been moderate, but easier monetary conditions should encourage stronger growth over the coming year.

Improved prospects for global demand have also led to a recovery in the world prices of primary commodities.

This commentary includes information received to 9 July 1999.

Against this background, and with Canada's current favourable competitive position, our exports should continue to register solid gains in the period ahead. Conditions are also encouraging for a sustained expansion in domestic spending in Canada—a scenario that is broadly supported by the recent evolution of the monetary and credit aggregates.

Overall, based on new information and developments since May, the Canadian economy now seems poised to achieve growth (on an annual average basis) in 1999 towards the upper end of the 2 3/4 to 3 3/4 per cent range indicated in the most recent *Monetary Policy Report*. The trend of inflation is still expected to edge up in coming months, but to remain in the lower half of the target range. Indicators of pressure on the economy's production capacity (e.g., inflation relative to expectations, costs, and the growth of money and credit) continue to support this outlook for inflation.

Highlights

- *Despite some lingering uncertainties on the global scene, developments since the May 1999* Monetary Policy Report *have resulted in a firmer tone in the outlook for the world economy and for Canada.*
- *The Canadian economy now appears poised to attain growth in 1999 towards the upper end of the 2 3/4 to 3 3/4 per cent range set out in the May* Report.
- *Trend inflation is still expected to edge up but to remain in the lower half of the Bank's inflation-control target range of 1 to 3 per cent.*

The International Environment

Emerging-market economies, Europe, and Japan

Circumstances in *emerging-market economies* continue to improve. In some of the Southeast Asian countries that were at the centre of the 1997-98 financial crisis, there are now clear signs of an economic turnaround. This is especially evident in South Korea, where industrial production has rebounded sharply, but is also the case in Thailand, Malaysia, and recently, in Indonesia. In Brazil, where financial conditions worsened towards the end of 1998 because of concerns about that country's fiscal and current account imbalances, the decision to float the *real* and the adoption of a new IMF-sponsored adjustment program have helped to stabilize the situation. Interest rates continue to come down, inflation has been falling, and output in Brazil and other parts of Latin America is now expected to be less affected than thought earlier. In Mexico, recent indicators point to a quickening pace of economic activity, with exports remaining strong, oil prices rising, and domestic demand recovering in response to the decline in interest rates.

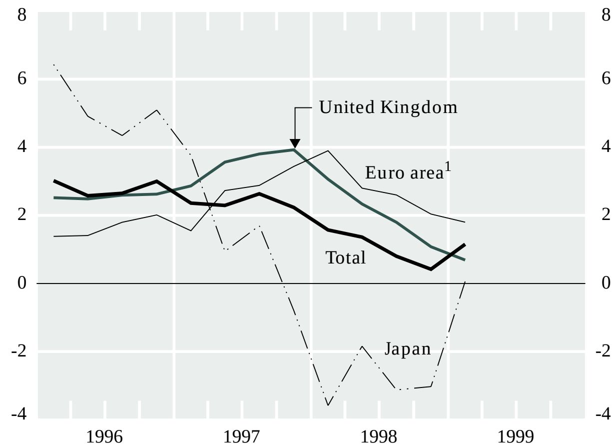
Circumstances in emerging-market economies are improving.

In the *euro area*, the pace of economic expansion has slowed noticeably since mid-1998 because of low business confidence and reduced exports to emerging markets. Growth patterns in the three major euro-area countries have diverged: economic activity in France has been better sustained than in either Germany or Italy. Easier monetary conditions across the euro area should support a stronger recovery over the coming year. In the *United Kingdom*, output growth has also slowed significantly from the unsustainable pace prior to 1998. A "soft landing" in that country in 1999 now seems to be a strong possibility, with a gradual strengthening in economic activity in coming months supported by the monetary easing that has taken place since last autumn.

In *Japan*, after five successive quarters of economic contraction, recent data show a sharp turnaround in real GDP in the first quarter of 1999, apparently influenced by stimulative fiscal measures. However, as

Real Gross Domestic Product in Overseas Countries

4-quarter percentage change



1. Austria, Belgium, Finland, France, Germany, Ireland, Italy, Luxembourg, Netherlands, Portugal, and Spain

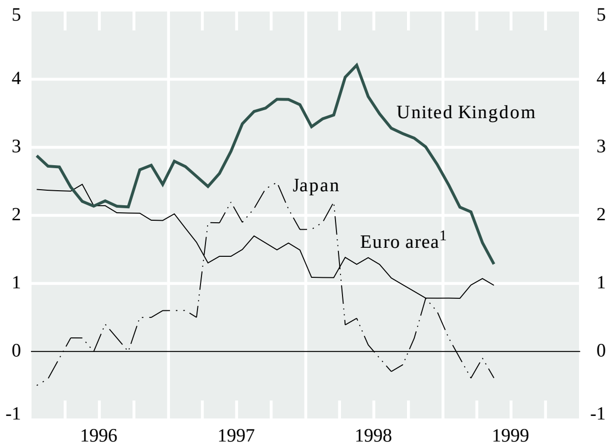
noted earlier, there are some questions at this point regarding the extent and durability of the upturn. Although business confidence has improved somewhat, against a backdrop of industrial and financial sector restructuring and deteriorating employment prospects, consumer confidence remains depressed. While the unemployment rate was down somewhat in May (to 4.6 per cent from a post-war high of 4.8 per cent in the previous two months), the jobs-to-applicants ratio hit an all-time low in May. Altogether, it is still unlikely that there will be much of an economic recovery in Japan this year.

In Europe, the pace of expansion remains moderate, but easier monetary conditions should help to support stronger activity over the coming year.

Consumer price inflation remains subdued in the major overseas industrial countries because of economic slack and lower prices for imports from emerging markets. In the euro area, the harmonized rate of inflation stands at about 1 per cent and is expected to remain low. In the United Kingdom, inflation (excluding mortgage rates) is currently below the Bank of England's target rate of 2.5 per cent. When the effects of increases in indirect taxes are also excluded,

Consumer Price Index in Overseas Countries

12-month percentage change



1. Austria, Belgium, Finland, France, Germany, Ireland, Italy, Luxembourg, Netherlands, Portugal, and Spain

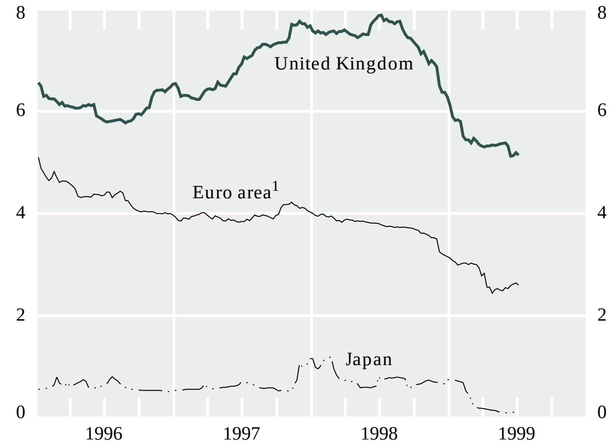
U.K. inflation is down to 1.5 per cent. In Japan, inflation has been slightly negative since early 1999. Slack in the economy and the past appreciation of the yen are expected to continue exerting downward pressure on prices in coming months. However, the extent of such pressure will likely be tempered by the rise in oil prices.

It is too early to determine if the recent rebound in the Japanese economy heralds the beginning of a sustained recovery.

Monetary conditions in the major overseas countries have generally become more accommodative in response to the slowing pace of economic activity and low current and prospective inflation. This is certainly true in the euro area, where lower interest rates and the marked depreciation of the euro on a trade-weighted basis against the six major currencies (C-6)[1]

90-Day Interest Rates in Overseas Countries

Wednesdays

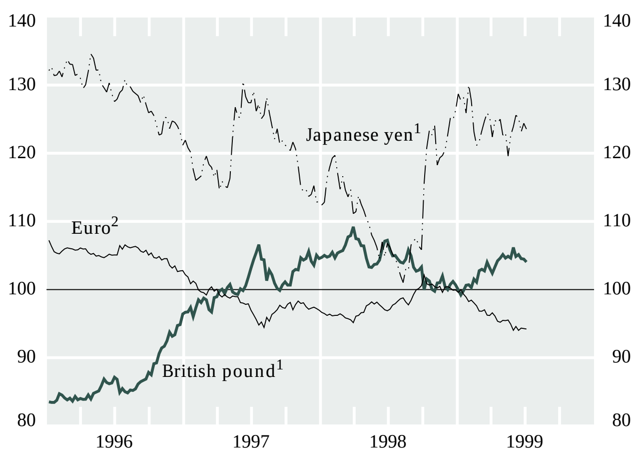


1. Synthetic euro-area interest rates are calculated for the period prior to January 1999 on the basis of GDP-weighted interest rates for Austria, Belgium, Finland, France, Germany, Ireland, Italy, Netherlands, and Spain.

have led to a significant monetary easing this year. In Japan, as well, monetary conditions have become more accommodative since early 1999 with the decline in interest rates and the effective depreciation of the yen. In the United Kingdom, monetary conditions have not changed much overall. The substantial appreciation of the pound sterling against the C-6 has largely offset the effect of two further cuts in official interest rates since the beginning of the year.

Exchange Rates of Selected Overseas Currencies

Nominal effective index vis-à-vis C-6 currencies, 1987 = 100, Wednesdays



1. Prior to 1999, based on the bilateral exchange rates of the participating countries in the euro area
2. Prior to 1999, based on the ECU

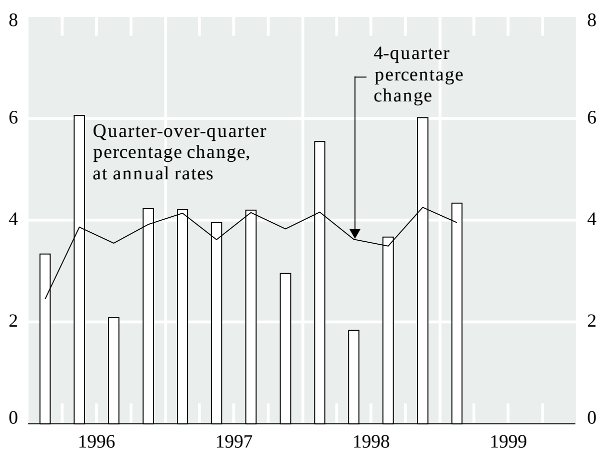
1. With the introduction of the euro in January 1999, the Bank of Canada has replaced its G-10 trade-weighted currency index with the C-6 index. The six foreign currencies in the new index are the U.S. dollar, the euro, the yen, the U.K. pound, the Swedish krona, and the Swiss franc. When the index is applied to the euro, the yen, the U.K. pound, or the U.S. dollar, it includes the Canadian dollar but excludes the reference currency.

United States

In the United States, output growth continues to outstrip most estimates of the growth of potential. With the economy thus pressing even more strongly against its capacity limits, there have been renewed concerns about latent inflationary pressures.

Real GDP rose at an annual rate of 4.3 per cent in the first quarter of 1999, following growth of 6 per cent in the previous quarter. This moderation in the overall pace of economic expansion occurred in the context of an acceleration in domestic demand, which was more than offset by a decline in real net exports. Solid gains in employment and real personal income, low mortgage rates, and unseasonably mild winter weather supported strong increases in all the major components of domestic demand. While consumer spending was the primary engine of demand growth, residential construction and business investment in machinery and equipment also rose rapidly. With strong domestic demand boosting imports, and with exports falling, net trade acted as a drag on the economy during the quarter.

U.S. Real Gross Domestic Product
Quarterly

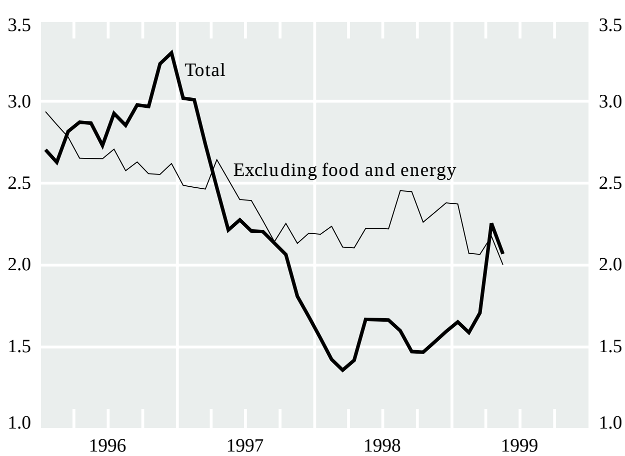


By all indications, the U.S. economy continued to expand vigorously in the second quarter. While growth in domestic demand probably slowed from the very rapid pace of the previous quarter, this should be largely offset by a rebound in exports. As we look further ahead into 1999, the negative personal savings rate, higher mortgage rates, and the expected moderation in employment gains suggest slower output growth. Even so, the U.S. economy will continue to operate at high levels.

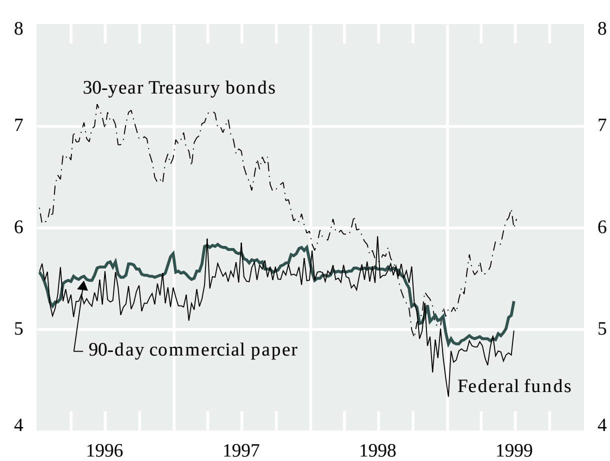
The U.S. economy continues to grow above potential, increasingly pressing against its capacity limits, and thus rekindling concerns about inflation.

The high rate of resource utilization in the U.S. economy is again focusing attention on the risks of overheating, and is raising concerns about incipient

U.S. Consumer Price Index
12-month percentage change

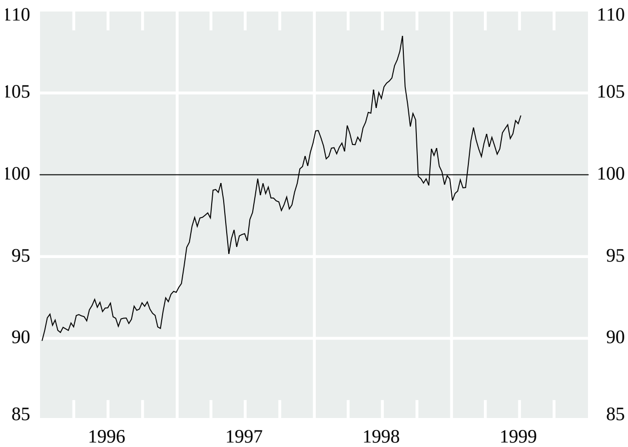


Selected U.S. Interest Rates
Wednesdays



U.S. Dollar Exchange Rate

Nominal effective index vis-à-vis C-6 currencies, 1987 = 100, Wednesdays



inflationary pressures, even though there are few visible signs as yet of a generalized pickup in underlying inflation. Core inflation (as measured by the 12-month rate of increase in the CPI excluding food and energy) was down to 2 per cent in May, partly dampened by the persistent appreciation of the U.S. dollar. Moreover, despite very tight labour markets (the unemployment rate was 4.3 per cent in June) and despite some pickup in wage growth, solid gains in productivity continue to limit increases in unit labour costs.

With dissipating financial strains, and given tight labour markets, the Fed reversed part of last autumn's easing in interest rates.

In view of the tight labour markets, and even though inflation remains contained for now, on 30 June, the Federal Reserve reversed part of the 75-basis-point reduction in interest rates effected last autumn in response to financial strains at home and abroad. The target rate for federal funds was thus raised by 25 basis points to 5 per cent. At the same time, the Fed indicated that although it was removing the tightening bias announced at its May meeting, it would remain alert for any signs of inflationary pressures.

Short-term money market rates have risen since May in anticipation of higher policy interest rates. The upward movement has been even more pronounced at the longer end of the yield curve, despite some reversal following the Fed's June meeting. The recent sharp widening of the spread between U.S. conventional and inflation-protected (real return) bonds suggests that longer-term inflation expectations may have risen.

With the increase in short-term interest rates and with the appreciation of the U.S. dollar on a trade-weighted basis, monetary conditions have tightened since the beginning of the year.

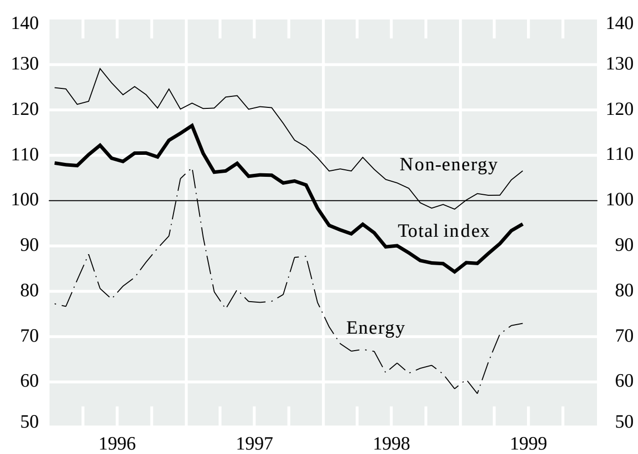
Commodity prices

The average price of the key primary commodities produced by Canada (as measured by the Bank's commodity price index in U.S. dollars) rose by about 13 per cent between its trough in December 1998 and June 1999. This increase has reversed about half of the losses sustained in the wake of the Asian crisis. Although much of the rebound reflects the surge in world crude oil prices, there has also been a significant recovery in the prices of several other commodities.

Crude oil prices have risen sharply this year, primarily because of high OPEC compliance with agreed-upon production cutbacks, but also because of strong U.S. demand for gasoline. Natural gas prices have also rebounded since early 1999, reflecting a decline in drilling activity and higher demand from electricity producers, as they switch from oil to gas.

Bank of Canada Commodity Price Index

1982–90 = 100, in U.S. dollars



Among non-energy commodities, there have been marked price increases for pulp and especially for lumber, reflecting rising demand and, in the case of lumber, very tight supplies. Prices for base metals are also up significantly, in response to improved world demand prospects and expectations of reduced supplies because of the closure of several major copper mines in the United States and Canada. In contrast, the price of gold has fallen sharply, partly in reaction to actual and anticipated gold sales by some major central banks and by the International Monetary Fund (the latter to finance debt relief for heavily indebted poor countries). Prices for grains and oilseeds remain weak, reflecting favourable growing conditions and improved yields. Livestock prices, however, have bounced back from the lows reached last December, mainly because of the surge in hog prices in response to tighter supplies and stronger demand.

Canadian Economic Developments

Aggregate demand, output, and employment

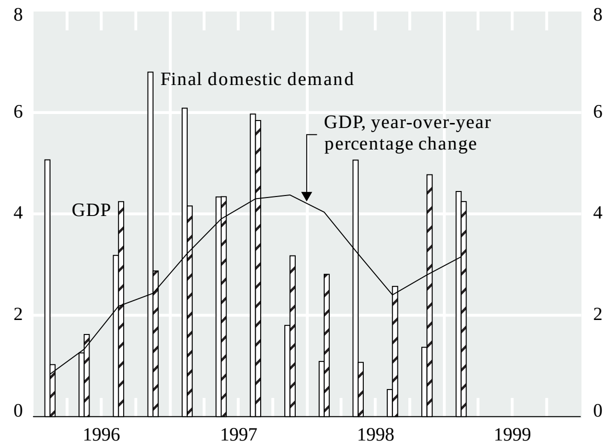
Real GDP in Canada rose by 4.2 per cent (at an annual rate) in the first quarter of 1999, broadly in line with expectations in the May *Monetary Policy Report*. The main stimulus to growth came from further substantial gains in export volumes, a rebound in household spending, and continued strong business investment. Part of the rise in demand was met out of imports and a reduction in inventory investment.

The Canadian economy continues to expand robustly supported by buoyant U.S. demand and broad-based growth in domestic demand.

Consumer spending strengthened in the early part of 1999 after two flat quarters. Significant increases were reported in most expenditure categories, especially durable goods, boosted by earlier strong employment growth, improved consumer confidence, and renewed financing incentives on motor vehicle sales. More normal weather conditions (after unusually mild winter

Output and Final Domestic Demand

Quarter-over-quarter percentage change, at annual rates



weather in the previous quarter) also contributed to increased spending on home heating and winter apparel. Since real personal disposable income increased only moderately in the quarter, the personal savings rate declined—to 1.5 per cent from 2.2 per cent in the preceding quarter.[2] Residential construction also rose considerably, with new housing construction, renovations, and resale activity all contributing to the increase. Business expenditures on machinery and equipment were again up substantially, in the main reflecting continued spending on computer hardware (partly related to achieving year-2000 compliance) and on other office equipment. However, spending on non-residential structures edged down.

A robust U.S. economy and the past real depreciation of the Canadian dollar continued to boost demand for Canadian exports, particularly of automotive products and machinery and equipment (computers, aircraft, and telecommunications equipment). In contrast, exports of energy, lumber, and agricultural and fish products declined. The rate of accumulation of non-farm business inventories eased in the first quarter. Some of the rundown in retail stocks, particularly of automobiles, was probably unintended, reflecting the stronger-than-anticipated recovery in sales.

2. Both personal income and savings levels were revised up in 1997 and 1998 because of upward revisions to labour income. For all of 1998, the revised savings rate is 2.3 per cent rather than the 1.2 per cent previously reported. For the fourth quarter of 1998, the savings rate is now 2.2 per cent instead of 0.8 per cent.

The volume of imports rose considerably in the first quarter, albeit less rapidly than that of exports. This largely reflected the strong growth in business purchases of machinery and equipment, which are import-intensive. There was also a weather-related rebound in energy imports from the unusually low levels of the fourth quarter.

The improvement in the real foreign balance and a recovery in the terms of trade (primarily stemming from the rise in commodity prices) led to a sizable increase in the merchandise trade surplus in current dollar terms. In turn, this contributed to an appreciable narrowing of the current account deficit—to 0.6 per cent of GDP from 1.8 per cent in the previous quarter.

Employment, after surging in the last quarter of 1998, rose again substantially in the first quarter because of strong growth in January. Gains, though broadly based, were particularly notable in paid, full-time jobs in the private sector, and also in employment for youths. However, since February, there has been little further change in total employment despite a modest increase in full-time jobs. Still, a moderate rise in the average work week and the recent large increase in the help-wanted index suggest that the pause in employment growth is probably temporary and that further gains can be expected in the future.

The outlook remains favourable for sustained economic expansion in coming quarters.

As we look ahead, conditions remain favourable for solid economic expansion in Canada. The ongoing buoyancy of U.S. domestic demand and the current competitive edge enjoyed by Canadian industry should continue to bolster export growth. Household spending should also remain firm, underpinned by accommodative monetary conditions, strong past and expected renewed growth in employment, the recovery in consumer confidence, and reductions in federal and provincial income taxes.[3]

Output growth in 1999 is now expected to be in the upper end of the 2 3/4 to 3 3/4 per cent range suggested in the May Report.

Early indicators for the second quarter support a scenario of continued healthy economic expansion. Labour income data and real GDP by industry at factor cost for April, as well as motor vehicle production and housing starts for June, all point to sustained underlying momentum. The Bank now expects second-quarter real GDP growth to be roughly similar to that in the preceding quarter. This puts the Canadian economy on a trajectory for growth in 1999 (on an annual average basis) in the upper end of the 2 3/4 to 3 3/4 per cent range indicated in the May *Monetary Policy Report*.

Prices and costs

The 12-month rate of increase in the core CPI (CPI excluding food, energy, and the effect of indirect taxes), which had been near the bottom of the 1 to 3 per cent target range through early 1999, edged up to 1.4 per cent in April-May—slightly higher than anticipated at the time of the last *Monetary Policy Report*. Two other measures of the trend rate of inflation, the CPIX and CPIW,[4] have closely followed the recent path of core inflation, remaining at or slightly above the latter.

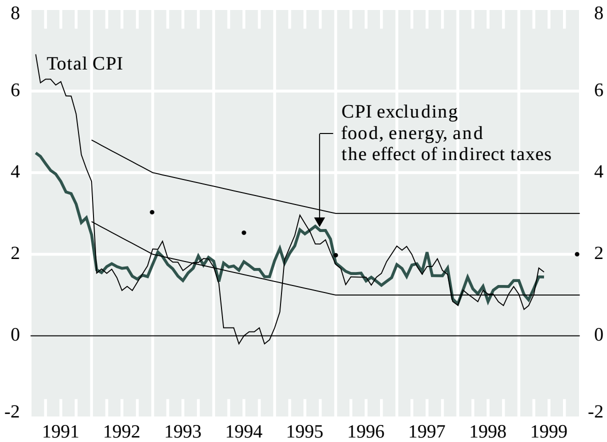
Total CPI inflation, which had slipped below core inflation under downward pressure from falling oil prices, has recently moved above the core rate, reflecting the rebound in those prices.

Over the past year, excess capacity in the economy and modest increases in unit labour costs have exerted downward pressure on core inflation. Intense retail competition and price discounting for long-distance telephone service and computer products (reflecting deregulation, technological advances, and lower costs

3. At the federal level, the 3 per cent surtax was eliminated and the amount for personal exemptions was raised, both effective in July 1999. Also in July, Alberta matched changes in federal personal exemptions, and Ontario and Manitoba cut personal income taxes. New Brunswick and Prince Edward Island lowered personal income tax rates in January 1999.

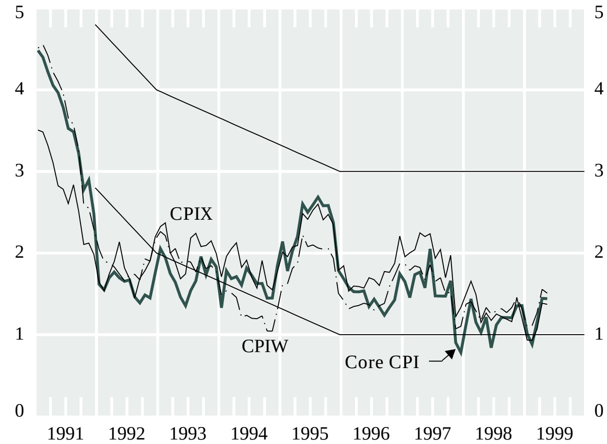
4. CPIX excludes from the CPI the eight most volatile components as well as the effect of indirect taxes on the remaining components. The CPIW measure incorporates an adjustment for each CPI basket weight that is inversely proportional to the component's variability. For further details, see T. Laflèche, "Statistical measures of the trend rate of inflation." *Bank of Canada Review* (Autumn 1997): 29–47.

Consumer Price Index
12-month percentage change



Target range
• Midpoint of the inflation-control target range

Core CPI and Statistical Measures of the Trend Inflation Rate
Year-over-year percentage change



Target range

of imported components) have also had a dampening influence. Factors working to hold inflation up have been the pass-through into consumer prices of the past depreciation of the Canadian dollar (which has become more evident recently) and longer-term expectations of inflation that are close to the midpoint of the target range.

These last two factors, together with the anticipated slowing in the rapid decline in computer prices and long-distance telephone rates, will tend to increase inflation in coming months. Nonetheless, the remaining slack in product and labour markets is still expected to keep core inflation in the lower half of the target range.

Trend inflation is expected to increase somewhat but remain in the lower half of the target range.

This low-inflation scenario is supported by the continued absence of any signs of wage or cost pressures. Wage inflation remains relatively moderate and broadly in line with expectations. The average annual increase for wage settlements in the unionized private sector was 2.3 per cent in the first four months of 1999, compared with 1.8 per cent for all of 1998. Over the same period, public sector settlements averaged 1.5 per cent, almost identical to the increase for 1998 as a whole. Total unit labour costs were down slightly, on a year-over-year basis, in the first quarter.

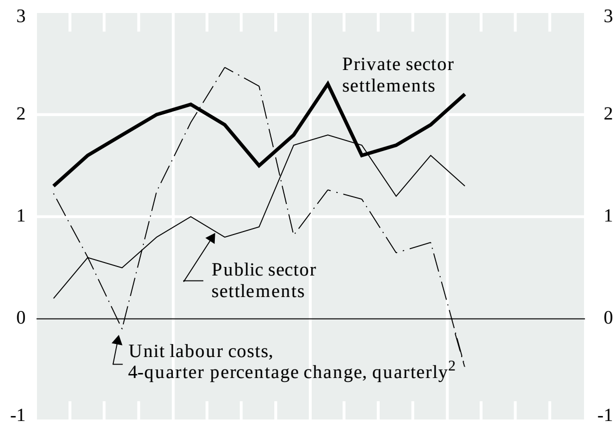
Labour costs are rising modestly, and expectations for longer-term inflation are still close to the midpoint of the target range.

The chain price index for GDP, a broad measure of the price level of goods and services based on weights that adjust for shifts in the composition of spending, rose 0.3 per cent on a year-over-year basis in the first quarter, after posting declines in the previous two quarters.

As noted above, in recent business surveys, longer-term inflation expectations remain at, or slightly below, the midpoint of the inflation-control target range. The yield differential between conventional long-term government bonds and Real Return Bonds, which is another measure of expected inflation, has widened somewhat from recent record lows, but it too remains below 2 per cent.

Wage Settlements[1] and Unit Labour Costs

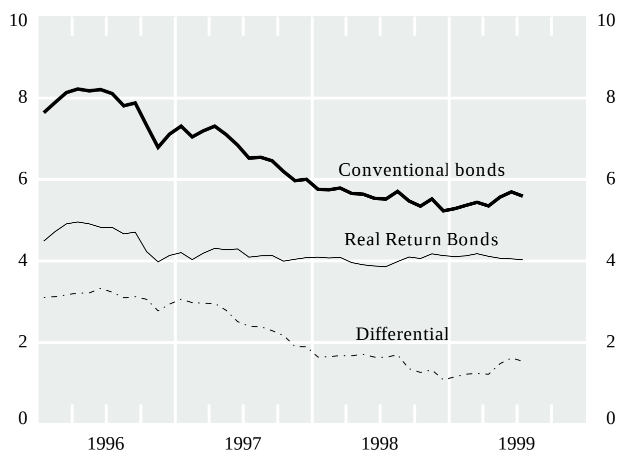
Per cent



1. Effective annual increase in base wage rates for newly negotiated settlements
2. Ratio of total labour income to real GDP

Yields on 30-Year Government Bonds

Monthly



Canadian Financial Market Developments and Monetary Policy Operations

Monetary and credit developments

The recent evolution of the narrow monetary aggregates supports the view of solid economic expansion in coming quarters. The rate of growth of the narrow money aggregates has picked up since the beginning of the year, following a marked slowing last autumn. This is particularly evident for M1+ and M1++, the two measures of transactions balances that are somewhat broader than M1.[5] These two aggregates take into account the substitution between demand deposits (which are included in M1) and notice deposits (which are not, even though they have become more accessible for transactions purposes).

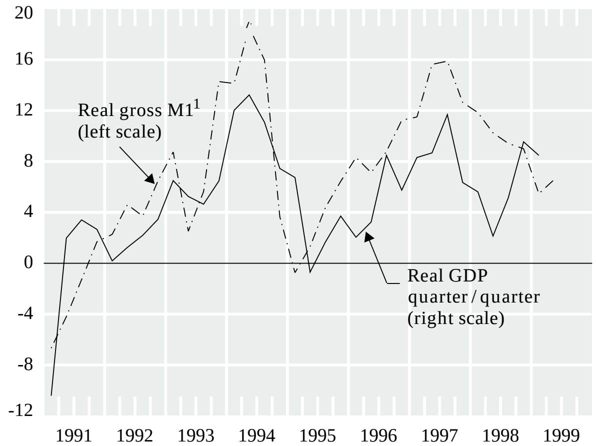
The recent growth of the monetary aggregates supports a scenario of continued solid output growth and low inflation in coming quarters.

Shifts in recent years between savings deposits (notice and fixed-term) and mutual funds have made it difficult to interpret the evolution of broad money as an indicator of short-term movements in nominal spending and core inflation. Specifically, with the huge shift out of deposits into equity and bond mutual funds, aggregates like M2 and M2+ tend to understate the expansion of holdings of liquid assets. M2++, which takes account of these shifts, is the Bank's preferred measure of broad money. Since the beginning of the year, this aggregate has been growing at a year-over-year rate of about 7 per cent, which is consistent with inflation remaining low in 1999.

5. M1+ and M1++ were introduced in the spring 1999 issue of the *Bank of Canada Review.*

Real GDP Growth and Growth of Real Gross M1

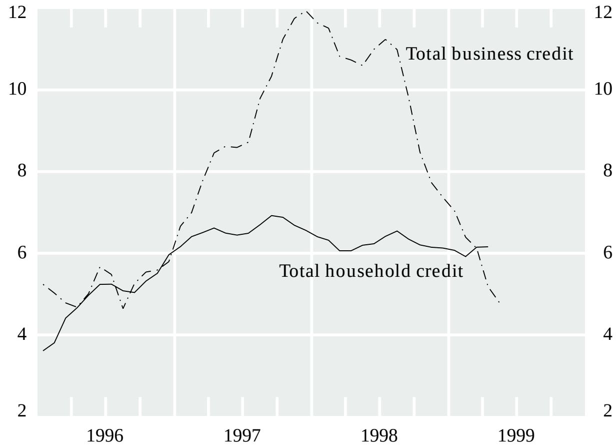
Annual rates



1. Two-quarter moving average of growth in gross M1 (deflated by the consumer price index), one quarter earlier

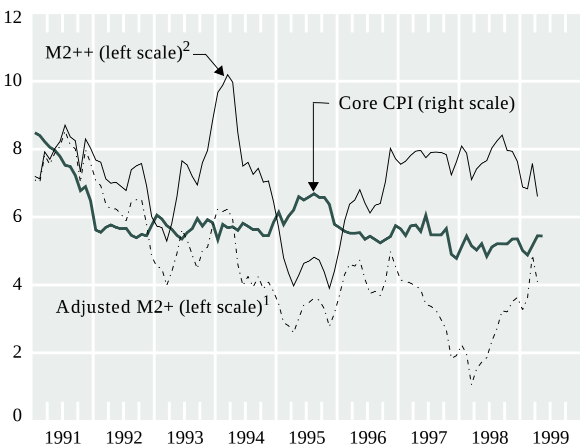
Credit Aggregates

12-month percentage change



Core Inflation and Broad Money Growth

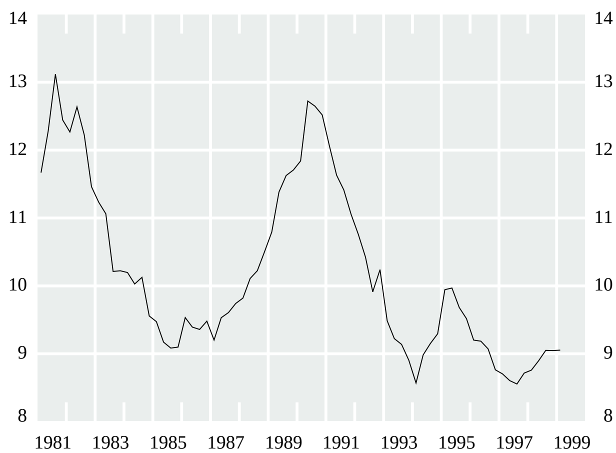
Year-over-year percentage change



1. Adjusted M2+ adds CSBs and mutual funds sponsored by certain financial institutions to M2+.
2. M2++ adds CSBs and all mutual funds to M2+.

Personal Sector[1] Debt-Service Ratio

As a percentage of personal disposable income, quarterly



1. Includes unincorporated businesses

In a climate of improved consumer confidence, and with the higher level of activity in the housing market, total household credit has been growing at a solid pace. With personal disposable income rising only moderately in the first quarter of 1999, the ratio of outstanding personal debt to disposable income increased, and the estimated ratio of interest payments to disposable income—the debt-service ratio—edged up. However, the latter remains well below its recent peak in the early 1990s and below the average for the past 20 years.

The growth of business credit remains hesitant, following a sharp slowing last autumn in the wake of heightened global financial uncertainty and the attendant tightening of credit conditions. The current pace of business borrowing is somewhat slower than might be considered normal for this stage of the cycle.

Monetary conditions and policy operations

As discussed in the May 1999 *Monetary Policy Report*, calmer international financial markets have made it possible to keep the focus of monetary policy on the medium-term objective of maintaining the trend of inflation within the target range.

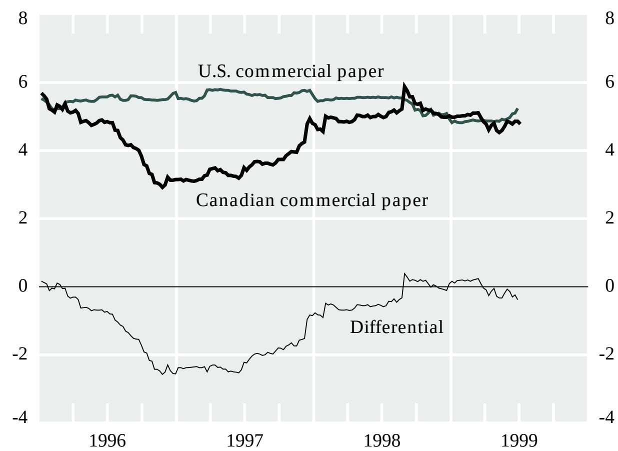
Accordingly, the Bank Rate has been reduced by 25 basis points on two occasions since the beginning of the year, 31 March and 4 May, to 4 3/4 per cent. The first of these cuts, together with three earlier ones (in September, October, and November 1998), fully reversed the one-percentage-point increase that was prompted by the financial turbulence last August. The May 1999 cut was designed to support sustained economic expansion and keep the trend of inflation, which had been at the lower end of the target range, comfortably inside the range over the next year.

Canadian interest rates at all maturities are, once again, below their U.S. counterparts.

Canadian short-term money market rates, which had risen following the mid-May announcement of a tightening bias in U.S. monetary policy, have eased after the Fed removed this bias at the June meeting. Rates on 90-day commercial paper are lower than at the start of the year and they are, once again, significantly below comparable U.S. rates. Canadian bond yields have risen from their historically low levels at the turn of the year. However, they have increased by less than those in the United States. This reflects the view that inflationary risks in that country are greater than in Canada. Thus, the Canada-U.S. spread on 30-year government bonds has also become negative again and is currently at about -40 basis points.

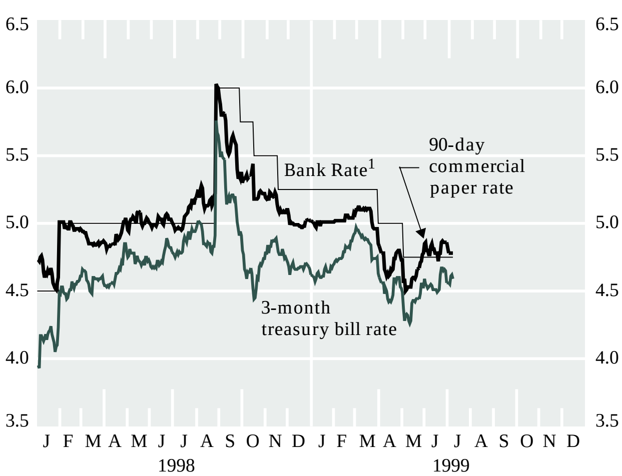
90-Day Interest Rates—Canada and the United States

Wednesdays



Rates on 90-Day Commercial Paper, 3-Month Treasury Bills, and the Bank Rate

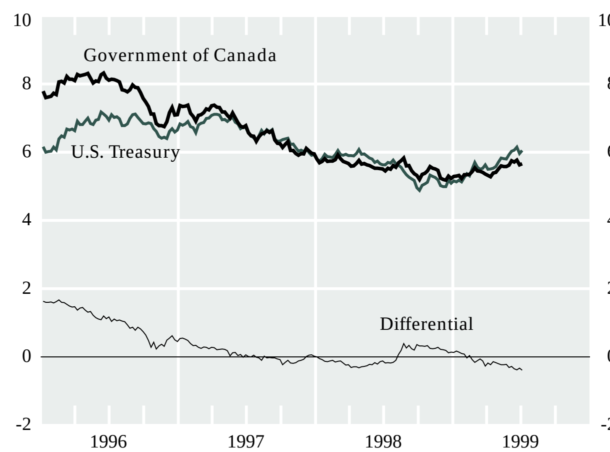
Daily



1. As of February 1996, the Bank Rate has been the upper limit of the operating band for the overnight rate.

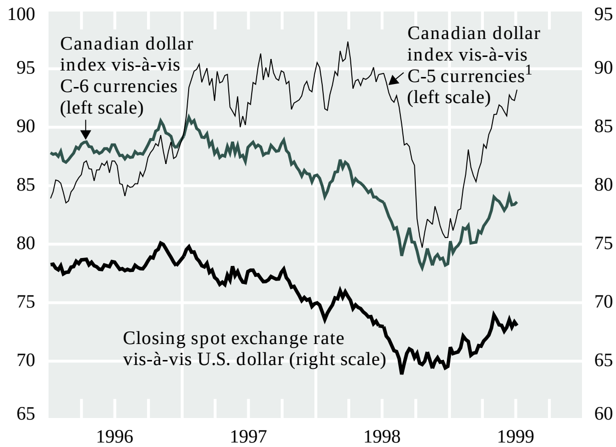
Government 30-Year Bond Yields—Canada and the United States

Wednesdays



Canadian Dollar Exchange Rate

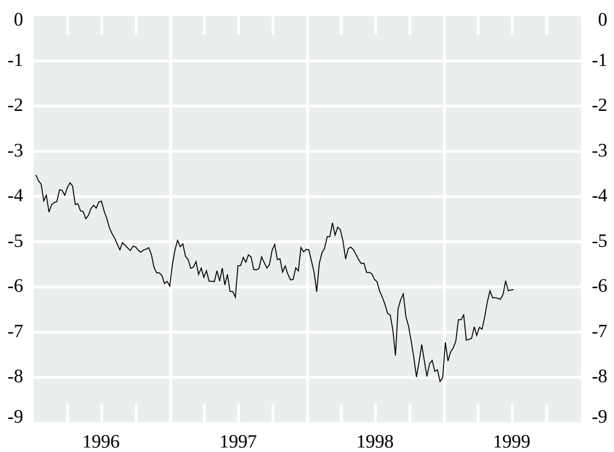
1992 = 100, Wednesdays — In U.S. cents



1. The C-5 index excludes the U.S. dollar.

Monetary Conditions Index

Wednesdays, January 1987 = 0



This index is calculated as the change in the 90-day commercial paper rate since January 1987 plus one-third of the percentage change in the effective exchange rate of the Canadian dollar against the other C-6 currencies since January 1987.

The Canadian dollar has strengthened considerably since early 1999, supported by the general firmness of domestic demand and the improved outlook for world commodity prices. Overall, the currency has appreciated by about 3.5 per cent against the U.S. dollar. On a trade-weighted basis vis-à-vis the six major currencies, the Canadian dollar has gained about 5.5 per cent. This is because both the Canadian dollar and the U.S. dollar have risen strongly against the other currencies, particularly the euro, owing mainly to the relative strength of the North American economy.

The Canadian dollar has strengthened.

With the strengthening trend in the trade-weighted exchange value of the Canadian dollar, monetary conditions have, on balance, tightened since the start of the year despite the decline in short-term interest rates.

In response to the further cuts in the Bank Rate this year, chartered banks lowered their prime rate twice, by a total of 50 basis points, to 6 1/4 per cent. However, with the rise in bond yields, the typical 1-year mortgage rate has increased by 50 basis points since the beginning of 1999, to 6.70 per cent, while the 5-year rate has risen by 90 basis points, to 7.50 per cent.