Opening Statement by
Gordon Thiessen
Governor of the Bank of Canada
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Standing Committee on Finance
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Mr. Chairman, my colleagues and I are pleased to appear before your committee on a regular basis following the release of the Bank of Canada’s *Monetary Policy Report*. It gives us a chance to discuss with you a range of economic and monetary issues. More generally, our semi-annual Report and sessions such as this one provide an opportunity for us to account for our actions and the results of those actions.

Before I turn to our recent *Monetary Policy Report,* I would like to say a few words about the objective of monetary policy. In February 1998, the government and the Bank of Canada jointly reaffirmed that Canada's monetary policy can best contribute to good economic performance by remaining focussed on inflation control. Keeping inflation low helps businesses and individuals to make sound economic decisions, and it helps moderate cyclical fluctuations in incomes and employment. The February announcement extended our 1 to 3 per cent target range for inflation control out to the end of 2001.

Let me remind you that monetary policy has its effects on the economy with long lags. For that reason, decisions about policy actions to achieve this target for inflation-control have to be forward-looking and thus are based on projections of an uncertain future.

Since the release of our previous *Report* last November, there have been an unusual number of unanticipated international and domestic developments that have had important economic and financial consequences for Canada. These include the extent of the crisis in Asia, declines in primary commodities prices, and the persistent weakness of the Japanese economy. At home, there were strikes by Ontario's teachers and by postal workers, as well as the January ice storm in eastern Canada. In the United

States, the economy has been substantially stronger than expected. These developments have resulted in a higher-than-usual degree of uncertainty surrounding the economic outlook.

When we add up the effects of recent events, we see the economy continuing on a solid growth path, although not at the same rapid pace as in 1997. Despite the effects of developments in Asia, our economy is being supported by vigorous U.S. economic activity and by accommodative monetary conditions. Inflation is expected to remain inside our target range.

While the uncertainty surrounding the outlook is greater than normal, the risks appeared balanced to us when we wrote this *Report*. Since then, there have been some signs of greater momentum in the economy, but they are not yet sufficient for us to revise our overall view.

This outlook implies that the economy would reach a level close to full capacity sometime during the course of 1999. As we noted in the *Report*, this path for the economy suggested to us that the recent range of monetary conditions would be broadly appropriate during the next six months in the absence of further shocks. Let me stress that this is a judgement about the level of monetary conditions that currently looks appropriate. If there are economic or financial shocks that hit us from outside or the economy has more or less momentum than we can see at this time, we would of course reassess that judgement.

Let me also remind you that when we talk about monetary conditions we are talking about the combined influence of short-term interest rates <u>and</u> the exchange rate for the Canadian dollar. Given the degree of economic uncertainty that is likely to persist this year, monetary conditions may fluctuate over a relatively wide range, as they have recently.

Beyond the next six months, if the underlying momentum of the economy remains as strong as we currently anticipate, less-stimulative monetary conditions would be called for as the economy approaches and achieves full capacity.

I want to emphasize just how important it is to ensure that our economy reaches full capacity in a smooth and sustainable way. What we have learned over the last 25 years is that taking risks that could set off an inflationary boom means taking risks of falling into a serious recession, which would inevitably follow. It is by keeping the current economic expansion on a non-inflationary, sustainable growth path that we will get the best gains in incomes and employment that our economy is capable of producing.