Mr Thiessen's statement on the Bank of Canada's Monetary Policy Report

Opening statement of the Governor of the Bank of Canada, Mr Gordon Thiessen, before the Standing Committee on Finance of the House of Commons on 26 May 1999.

It is always a pleasure to appear before your Committee following the publication of our Monetary Policy Report. We released our ninth Report last Wednesday. The Bank of Canada began publishing these Reports on a semiannual basis four years ago, as part of our effort to increase the transparency and accountability of the Bank's conduct of monetary policy.

The main focus of every Monetary Policy Report is how well Canada is doing in managing inflation. But controlling inflation is not an end in itself. The objective of monetary policy is to help create and maintain a monetary climate that favours good economic performance, an economy where growth and employment are strong and Canadians feel prosperous. The Bank feels strongly that the best thing that monetary policy can do to help long-term growth in the economy is to preserve low and stable inflation. Indeed, I believe the low and stable inflation rate we have had in Canada in recent years has helped us through some difficult times.

However, I am also happy to report that the global financial system is much more stable than it was at the time of my last appearance before you six months ago. The shock from the financial crisis in Southeast Asia, which began almost two years ago, was compounded last August by Russia's default on its external debt. The turbulence that followed has now largely subsided and investor confidence is being restored. As a result, the outlook for the world economy has become more positive than it was last November.

Financial markets have steadied in Southeast Asia, and prospects are good for a gradual recovery there. In Brazil the authorities have taken major steps to address their difficulties. Overall, global financial markets now seem better able to assess risk. Interest rate cuts by central banks in all major countries have helped restore investor confidence.

Most importantly for Canada, the US economy has continued to outperform expectations with strong growth and, as yet, no definitive sign of inflation pressure. Nonetheless, there is still a fair degree of uncertainty about the overall external environment, given the divergent performance of the major economies. Japan is still in recession and Europe has been slowing down. Because of this, we are expecting only a slow recovery in world commodity prices this year.

In Canada, the recent driving force in our economy has been exports. The strong demand in the US economy, the relatively weak Canadian dollar and increasingly competitive Canadian manufacturers are allowing us to sell into the United States very successfully.

What we are expecting to see now, however, is an increase here at home in consumer and business spending. We believe that the improvement in business and consumer confidence that we have seen in the last few months, the better employment picture and recent reductions in interest rates will all help support domestic spending.

To be more specific, compared with six months ago, we at the Bank have raised our projection for growth in the economy in 1999 to between 2¾ and 3¾ per cent. We have such a wide range because of the international uncertainties that I mentioned a moment ago. The high end of this range is well above the latest consensus among private sector forecasters. If the economy does grow at the higher end of this range, it is likely to be because of stronger exports and more substitutions of Canadian goods for imports due to Canada's good price and cost performance. Our economy should continue to expand next year at a broadly similar pace.

On the basis of these growth forecasts, we would expect the trend of inflation to rise modestly over the next 18 months but remain in the lower half of the Bank's 1 to 3 per cent target range for inflation. There is an increasing level of confidence, both at home and abroad, that Canada's inflation will remain stable.

Another source of uncertainty for the Bank at the present time is in estimating the margin of unused capacity in the economy. If economic activity expands as forecast, the traditional way of measuring these things tells us that the current margin of economic slack should be taken up in the second half of next year. However, the economy seems to have undergone some significant changes during the 1990s, and the traditional estimates of slack may no longer be accurate. As a result, the Bank will be placing increased weight on a range of indicators to assess the degree of pressure on the economy's production capacity. What we have in mind are such things as movements in inflation relative to expectations, growth of money and credit, wage pressures, evidence of supply bottlenecks and the information provided to our regional representatives from their business contacts.

We will not know just how much the Canadian economy has changed until its capacity limits come under more pressure. While the confidence of Canadians in ongoing low inflation allows monetary policy more room to accommodate demand pressures that test the limits of capacity, it will be very important for the Bank to be vigilant in following the array of indicators I have mentioned. We must not undermine the solid basis of low inflation and low interest rates that has been established in Canada.