STATEMENT FROM THE GOVERNOR

Gordon Thiessen

I want to begin this year's report by commenting on some of the economic developments that are on the minds of Canadians. After that, I would like to highlight a few of the events that show how the Bank of Canada fulfilled its commitments to Canadians during 1997.

Canada's economic prospects

The problems being faced by the countries of Southeast Asia, South Korea, and Japan are leading to estimates of slower growth in the world economy and to predictions of downward pressures on international inflation rates. Canada has found itself caught up by some of the reactions to these Asian problems in international financial markets and in markets for the primary commodities that we export. Lower commodity prices and nervous investors turning to the U.S. dollar in search of a safe haven have contributed to the recent weakness in the Canadian dollar.

For the economy as a whole, prospects remain bright.

In such a period of uncertainty and nervousness, it is useful to look again at the basic situation of the Canadian economy. In fact, that situation remains remarkably positive. For much of the last 25 years, the Canadian economy has suffered from three major shortcomings: a high inflation rate, persistent budget deficits that led to very high levels of public debt, and a private business sector that had managed only relatively small gains in productivity over the period and was slow to gear up to the increasing competition being generated by new technology and more open international markets. Recently, Canada has made remarkable progress in all three areas. Our inflation rate has been 2 per cent or less for the past six years. The fiscal situation of the federal government and most provinces is close to balance or in surplus. The ratio of accumulated government debt relative to the size of our economy is finally starting to fall. As well, Canadian companies have made major adjustments over recent years, adopting new technologies and becoming more internationally competitive.

Canadian companies have made major adjustments over recent years, adopting new technologies and becoming more internationally competitive.

There is no doubt that the impact of events in Asia will be felt more strongly in those industries and regions with the closest trade links to Asia and those associated with primary commodities. As well, the ice storm that hit eastern Ontario, Quebec, and parts of the Maritimes in January 1998 has had a short-term impact on economic activity. Nonetheless, for the economy as a whole, prospects remain bright. The combination of internationally competitive Canadian firms and a robust U.S. economy should mean that most export industries will continue to prosper. At the same time, the low interest rates in Canada, made possible by low inflation and improved government finances, will continue to support spending by businesses on new technology, machinery, and equipment and by households on housing, motor vehicles, and other durable goods. The improved fundamentals underlying our economy enable Canada to absorb and adjust to international shocks, like the events in Asia, more easily than in the past.

The Canadian economy expanded strongly, at a rate of about 4 per cent through 1997. I expect that, despite the negative effects from Asia, our economy will still grow at a healthy pace in 1998. During 1997, there was a net increase of nearly 380,000 full-time jobs in the private sector, and the employment picture should continue to improve in 1998.

Although the unemployment rate fell by a full percentage point in 1997, for many Canadians our unemployment rate of 8.6 per cent at year-end is still an indicator of a tough job market. Public opinion polls suggest that many parents expect that their children will have a harder time than they did finding and keeping jobs.

There is no question that the Canadian economy has been going through a major and difficult period of adjustment. Many jobs have been eliminated and others have changed dramatically. Employees are increasingly expected to acquire new skills. But many of them fear that rapidly changing technology will soon render even those new skills obsolete.

But beneath all these changes and uncertainties are signs of more promising employment prospects. Recent economic developments in the United States provide a concrete illustration of what is possible. The U.S. economy has been ahead of us in adjusting to the changing world economy that I have been describing. The United States is in its seventh year of economic expansion with sustained gains in employment and an unemployment rate that is the lowest since 1973.

This kind of performance has been possible because U.S. firms have become highly competitive internationally and have been quick to adjust to changing markets and technologies. But translating these advantages into a low unemployment rate has required a reasonably stable growth path for the economy because that makes employers more confident about investing in their workforce and hiring new employees.

Inflation is low, and by pursuing a monetary policy designed to keep inflation under control, the Bank of Canada is contributing to making the economic expansion in Canada as long-lasting as possible.

I cannot stress too strongly just how important the policy of low inflation pursued by the U.S. central bank has been in achieving that economic stability. History shows that once inflation begins to take hold, the seeds of a recession are sown. The worse the inflation, the worse the subsequent recession.

All this leads me to be rather optimistic about the prospects for an improved employment situation in Canada. Inflation is low, and by pursuing a monetary policy designed to keep inflation under control, the Bank of Canada is contributing to making the economic expansion in Canada as long-lasting as possible. If the Canadian economy continues to demonstrate a capacity to become more efficient and more flexible in responding to change, and once we get through the effects of the problems in Asia, we should be looking at better prospects for economic growth and employment than we have seen for some time.

Fulfilling the Bank's commitment

The Bank's commitments to Canadians are set out on page four. I want to say a few words about how the Bank worked to fulfil these objectives in 1997. A more detailed account of our stewardship is provided in the subsequent sections of this report.

The first commitment, to conduct monetary policy in a way that fosters confidence in the value of money, is translated into concrete terms through our inflation-control target range of 1 to 3 per cent. Chronic inflation erodes the value of money. In February 1998, the Government of Canada and the Bank of Canada jointly agreed that this current target would be extended through to the end of the year 2001. The press release issued by the Bank to explain this decision is reproduced on page 56.

Late in 1997, the inflation rate, as measured by the consumer price index, fell just below the Bank's target range. This was the result of a number of temporary influences and does not reflect the underlying trend of inflation in Canada. Nonetheless, the fact that the trend of inflation is near the bottom of the 1 to 3 per cent range highlights the point I made earlier that there is plenty of room for our economy to expand.

The Bank's commitment to promoting the safety and soundness of the financial system acquired a legislative mandate in 1996, when the Payment Clearing and Settlement Act came into force. This means that much of the work that the Bank had been doing to increase the

PHOTO: HELEN MEUBUS, COMMUNICATIONS SERVICES DEPT.

L-R: Bernard Bonin, Gordon Thiessen, and Charles Freedman at an appearance before the House of Commons Finance Committee

security of our financial system now becomes a legal obligation on the Bank. This past year we began to implement the legislation by issuing a guideline on how we would carry out our oversight responsibilities.

Our commitment to supplying bank notes that are readily accepted without concerns about counterfeiting has led the Bank to increase its investment in research and development of anti-counterfeiting features and production methods in preparation for the next generation of bank notes. While counterfeiting is not a serious problem in Canada, it has been rising, making it all the more important that we make use of the most effective anti-counterfeiting devices available.

The commitment to providing efficient and effective central banking and debt-management services has been bolstered by the new financial arrangements put in place between the Bank and Canada Investment and Savings, an agency of the Department of Finance set up to manage the sale of federal government debt to individual savers. Beginning in 1997, the Bank has been able to charge the agency for the services the Bank provides to support the issue of Canada Savings Bonds and other “retail” debt. This change will improve accountability.

The Bank continued its efforts to meet its commitment to communicate openly with Canadians and to be accountable for its actions.

The Bank continued its efforts to meet its commitment to communicate openly with Canadians and to be accountable for its actions. An important step was taken in 1997 to increase the Bank’s contact with individuals, groups, and provincial governments through new regional offices in Calgary and Halifax and expanded operations in Vancouver, Toronto, and Montreal. Our officers in these locations are responsible for promoting dialogue on monetary policy issues and on various operational aspects of the Bank’s work in the regions. Experience has shown that both the economy and monetary policy work better when Canadians are well informed about current economic issues and about the focus of monetary policy. And to do our job well, we at the Bank need to gather information from a wide range of sources and to listen to the views and concerns of Canadians.

The commitment to communicate openly faced a major challenge this year when evidence came to light that the Bank might have been involved in wartime gold transactions undertaken to help neutral countries make use of gold looted by Nazi Germany from other countries and from individuals. The finding of the investigation—that the Bank was not involved in such transactions—is described on page 31. What I would like to record here is that the Bank responded promptly and openly to the allegations and that our staff worked long and hard to ensure that the historian engaged by the Bank to assess the information had ready access to all the material on the subject, allowing him to complete his work quickly and with confidence in his sources.

* * *

Finally, I would like to add a word on the Bank of Canada as an institution. The Bank continues to undergo major adjustments. Although the review of our core responsibilities—what is crucial to the institution and what is not—is now largely behind us, some of the implications for the internal organization of the Bank and its staff are still being worked through. As well, like many other institutions, the Bank has been investing in technology to bring new efficiencies to its operations. We have also engaged in early identification of what we need to do to address the problems that the year 2000 creates for our automated systems.

The Bank had about 20 per cent fewer staff in 1997 than in 1994. At the same time, the skills required on the part of our employees and the types of positions needed in the Bank have changed enormously. This has demanded a large degree of flexibility and a willingness to acquire new skills. The staff has responded in a remarkable fashion. I want to take this opportunity to thank them all for their commitment to the process of change, their extra effort to make the changes work, and their patience in living with all the uncertainties and frustrations as well as the excitement that change brings.

Gordon Thiessen