## Monetary Policy

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The goal of Canadian monetary policy is to help the economy reach its full potential and thus contribute to rising living standards for all Canadians. The means for achieving this goal is to maintain stability in the value of money, because this will help businesses and individuals make sounder economic decisions and will moderate cyclical fluctuations in income and employment.

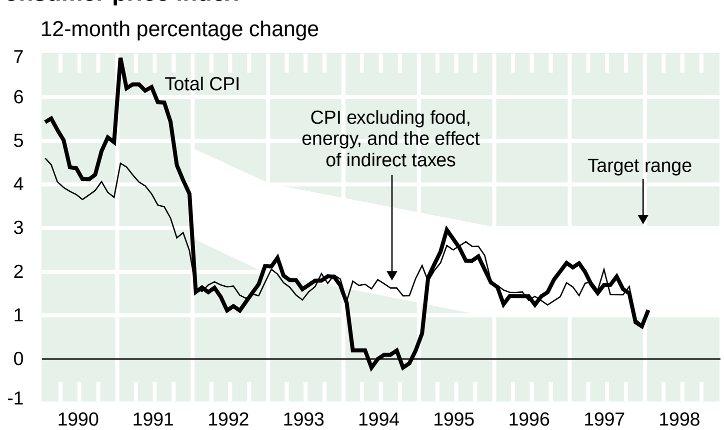
To make this objective more concrete, the Bank of Canada and the federal government have adopted an explicit target range for the rate of inflation, as measured by the annual rate of change in the consumer price index. For the period since 1995, the target range has been 1 to 3 per cent. In early 1998, this target was extended to the end of 2001 (see page 56).

The Bank implements monetary policy through its influence on monetary conditions—the combined pressures exerted on the economy by the level of short-term interest rates and the exchange rate for the Canadian dollar. The effect of changes in monetary conditions on inflation is usually felt over a period of 18 months to two years.

### Year in review

Inflation stayed between 1 1/2 per cent and 2 per cent for the first 10 months of the year, before dropping slightly below the target range late in the year, partly because of temporary discounts by retailers. In December, the total consumer price index (CPI) was up by 0.7 per cent from a year earlier; *core* CPI, which excludes volatile food and energy prices and the effect of changes in indirect taxes, was up by 0.8 per cent. Inflation is expected to move back inside the target range in the early part of 1998, once the effect of these temporary factors unwinds. (In January, both the total and core CPI were up 1.1 per cent on a year-over-year basis.)

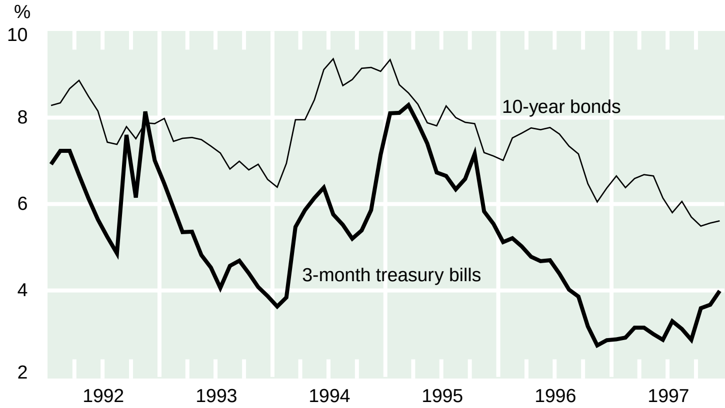
**Consumer price index**




With a dramatically improved fiscal situation, the Canadian economy has continued to derive increasing benefits from a low and stable inflation environment. In 1996, interest rates fell to their lowest levels in decades. Long-term interest rates declined further in 1997, as expectations of inflation and interest rate premiums generated by inflation uncertainty continued to come down.

Over the past year, inflation expectations have become increasingly consistent with the Bank's target for inflation control. This has given monetary policy more flexibility to respond to economic developments in Canada.

**Canadian interest rates**




In the last several years, the Bank has taken a number of initiatives to improve and enhance communications on monetary policy. In 1997, it took another major step in that direction by opening new offices in Halifax and Calgary and by expanding existing regional offices in Vancouver, Toronto, and Montreal. Representatives from these offices accompanied members of the Governing Council and of the Board of Directors in their outreach activities across the country. They also participated in briefing sessions held to discuss the *Monetary Policy Report*. The report, which is published in May and November, has itself become more open in its assessment of the economic outlook and in its discussion of the implications for monetary policy.

The Bank is also engaged in an ongoing dialogue with academics and other researchers to ensure that the formulation of monetary policy rests on high-quality analysis and research. Communication takes many forms—networking, participation at conferences, publication of research by Bank staff, and the hosting of conferences. The opening of regional offices is adding new opportunities for dialogue. The Halifax office, for example, has initiated joint projects with local researchers.

The Bank published a record number of research papers in 1997. It also published the proceedings of its 1996 annual economics conference, which dealt with the exchange rate and monetary policy. Research in 1997 focussed on the definition of price stability and the design of inflation-control targets—the topic of the 1997 conference hosted in May. The conference featured research by Bank economists and Canadian academics and also included a round-table discussion by officials of three other central banks on their experience with inflation-control targets. The conference proceedings were published in early 1998.

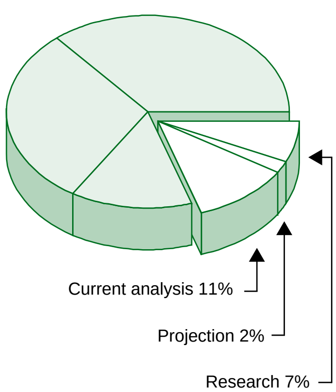
The 1998 conference, planned for this spring, will present results from recent research undertaken to extract information from financial market prices about market expectations and risk premiums. The 1999 conference will return to the role of monetary aggregates in the conduct of monetary policy, a subject of continuous study at the Bank.

The Bank collects data from financial institutions and uses it to monitor monetary and financial developments for the purpose of conducting monetary policy and to assess the safety and soundness of the financial system. The same data are also used by the Office of the Superintendent of Financial Institutions and by the Canada Deposit Insurance Corporation. Redevelopment of the Bank's system for processing these data was undertaken this year in collaboration with those two agencies under a cost-sharing agreement. Such collaboration helps lower the overall costs for all three agencies.

*Senior Regional Representative Michael Stockfish with commerce students at the University of British Columbia*

At the international level, Bank staff participate in regular meetings of the major economic and financial organizations, sharing views and information on domestic and international issues related to monetary policy. The Bank also provides advice and support to government departments, the Canadian office at the IMF, and the Canadian mission to the Organisation for Economic Co-operation and Development (OECD) on international economic and financial issues. During the second half of 1997, special attention was paid to developments in Asia and their impact globally and on the domestic economy.

**Operating expenses related to monetary policy formulation**




## Operating expenses

The Bank spent just over $37 million, or approximately 20 per cent of its total operating expenses in 1997, on monetary policy formulation. This represents an increase of about $2 million (nearly 7 per cent) over 1996. The establishment of the regional office network accounts for two-thirds of this increase.