



BANK OF CANADA ANNUAL REPORT

2 0 0 1



BANK OF CANADA
David A. Dodge
Governor - Gouverneur



BANQUE DU CANADA
Ottawa K1A 0G9

28 February 2002

The Honourable Paul Martin, PC, MP
Minister of Finance
Ottawa

Dear Mr. Martin,

In accordance with the provisions of the Bank of Canada Act, I am submitting the Bank of Canada's *Annual Report* for the year 2001 and the Bank's audited financial statements as at 31 December 2001.

Yours sincerely,

A handwritten signature in black ink, which appears to be 'D. Dodge', written in a cursive style.

OUR COMMITMENT TO CANADIANS



- To contribute to the economic well-being of Canadians by
 - conducting monetary policy in a way that fosters confidence in the value of money
 - promoting the safety and soundness of Canada's financial system
 - supplying bank notes that are readily accepted without concerns about counterfeiting
- To provide efficient and effective central banking and debt-management services
- To communicate our objectives openly and effectively and to be accountable for our actions



Head Office, Ottawa

<i>Message from the Governor</i>	5
<i>About the Bank</i>	9
<i>An Account of Our Stewardship</i>	23
<i>Financial Summary</i>	45
<i>Financial Statements</i>	51
<i>Senior Officers</i>	67
<i>Regional Offices and Representatives</i>	68



MESSAGE FROM THE GOVERNOR



The year that just passed posed many challenges for all Canadians. The slowdown in the global economy became more pronounced as the year went on, and this affected households, businesses, and governments alike. The tragedy of 11 September compounded the economic difficulties and issues facing us all. Through this period of rapidly changing circumstances, the Bank met its responsibilities by responding quickly and vigorously to events in order to underpin confidence and support the economy.

For the staff of the Bank, changes in our operations and procedures also posed challenges. In this, my first Annual Report as Governor, I would like to touch on some of the key events and challenges faced by Canadians and by the Bank of Canada during the year.

Fixed Announcement Dates

Effective communication is critical if the Bank is to do its job properly. We try to explain to Canadians what we are doing, and why we are doing it. Equally importantly, we need to listen to Canadians and their concerns. Our new system of announcing interest rate decisions on eight pre-established dates fits with our goal of good communication. We experienced the first full year for our new system in 2001. The announcement dates were carefully chosen to tie into the flow of economic information used to assess the direction of monetary policy. This new system has allowed the Bank to focus greater public attention on Canada's monetary and economic situation. I'm pleased to say that, as a result, debate and discussion surrounding monetary policy issues in Canada appear to have benefited significantly.

In each of the first six fixed announcement dates in 2001, the Bank steadily lowered the target for the overnight rate of interest in response to signs that weakness in the U.S. economy was affecting Canada. But by the end of the summer, evidence had accumulated that the economic slowdown, not just in North America but globally, would be deeper and more protracted than previously thought. So, over the final two fixed dates, we quickened the pace of interest rate reduction to underpin domestic demand and to support a resumption of Canadian economic growth in the months ahead.

As well, we responded quickly to the devastating terrorist attacks of 11 September. Apart from the tragic loss of life, the attacks weakened Canada's economic prospects and made the outlook much more uncertain. Business

and consumer confidence were shaken. In response, the Bank lowered interest rates on 17 September—outside our fixed announcement schedule—to help underpin confidence.

Inflation-Control Targets Renewed

In 2001, we renewed a crucial agreement with the federal government—our agreement to keep inflation within a range of 1 to 3 per cent.

Since the Bank and the government first agreed to a system of inflation-control targets in 1991, Canada has enjoyed a decade of low, stable, and predictable inflation. With this agreement in place, Canadians have been able to make economic decisions with confidence, and with firm expectations about the influence that inflation would have on their future purchasing power. In response to our inflation-control record, inflation expectations in Canada have remained anchored near the 2 per cent midpoint of the target range.

Reflecting the success of Canada's inflation-control system, the Bank and the Government of Canada jointly announced, on 17 May, that the agreement would be extended for a full five years, until the end of 2006. It was also decided that the Bank would focus on keeping the trend of inflation at the 2 per cent midpoint of the target range over the life of the agreement. This renewed agreement, along with our flexible exchange rate system, should give Canadians added confidence that Canada will maintain a low rate of inflation for years to come.

More details about our targets, including refinements to our measure of core inflation, can be found on page 26 in this *Report*.

Restructuring for the Future

The Bank has been reviewing its strategic direction and key priorities for the next several years. The goal is to have a central bank that concentrates on its most important functions—conducting monetary policy, contributing to a stable financial system, designing and providing Canadians with secure bank notes, and managing the federal government's funds and public debt.

A major outcome of this strategic review was the decision to outsource the operations and systems that support the government's retail debt program. This will result in significant savings for Canadians. In September, about 430 of the Bank's staff, including consultants and contract employees, joined the successful contractor, EDS Canada. I am confident that our former colleagues are in a position to take advantage of new opportunities with a dynamic company that specializes in this type of business. Holders of Canada Savings Bonds can be assured that the Bank of Canada remains responsible for customer service, bondholder records, and accounting.

Further restructuring within the Bank will occur in the coming year, as we complete our review of corporate services to realign them with the future needs of a smaller Bank.

Bank Notes

Another challenge for the Bank in 2001 was a rise in counterfeiting activity, particularly of the \$100 note. Police in southern Ontario broke up a counterfeiting operation responsible for a wave of bogus \$100 notes, and the counterfeiters were convicted in October. Despite these actions by law-enforcement

agencies, a number of retailers have refused to accept \$100 notes. Although counterfeiting has now returned to low levels, we are stepping up our currency-education program, so that retailers and the general public can confidently accept genuine bills and readily spot counterfeits.

That counterfeiting episode points to the importance of the Bank's new bank note series, which contains new anti-counterfeiting features. The new \$10 note was released in 2001, and the new series will continue to be rolled out, with the \$5 note slated for 2002. Higher-denomination notes—the \$20, \$50, and \$100 notes—will incorporate additional security features and will be introduced over the next few years.

More details on bank notes can be found in the currency section of this *Report*, starting on page 30.

Supporting the Financial System

The events on 11 September presented another challenge to the Bank, beyond the impact on the economy. Following the attacks, the Bank moved quickly to make sure that Canada's financial system continued to operate smoothly. Bank staff reacted within minutes of the attacks to assess the impact on our clearing and settlement systems, and the Bank stepped in with liquidity to ensure that these vital systems continued to function. We also worked closely with other agencies and institutions, both in Canada and abroad. Our swap facility with the U.S. Federal Reserve was temporarily increased to ensure that Canadian banks would be able to settle their U.S.-dollar transactions in the aftermath of the attacks. In light of these

disruptions, the Bank—in conjunction with the Department of Finance—postponed an auction of federal government treasury bills for two days and an auction of Real Return Bonds for one week, without threatening the government’s cash position.



Before concluding, I would like to mention the death in July of Deputy Governor Tim Noël. All of us at the Bank were saddened by Tim’s passing, which came at the end of a two-year battle with amyotrophic lateral sclerosis. Tim left his mark on the Bank in many ways during a career that spanned 35 years. His substantial contributions in the area of financial markets will remain a valuable legacy, while his expertise and counsel will be sorely missed.

In all, 2001 presented the Bank’s staff with some extraordinary challenges. But these challenges were met with the high levels of skill and professionalism for which the Bank’s employees are known. As well, I am grateful for the support received from the Bank’s Board of Directors throughout the year. To them, and to all the employees of the Bank, I extend my thanks for your help during a challenging year, and I look forward to working with you as we continue to meet our commitments to Canadians during 2002.

A handwritten signature in black ink, appearing to read 'D. Dodge', with a stylized, flowing script.

David A. Dodge