



BANK OF CANADA ANNUAL REPORT

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CELEBRATING 70 YEARS { 1935-2005 }



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CELEBRATING 70 YEARS



Bank of Canada • Banque du Canada



Ottawa K1A 0G9

David A. Dodge
Governor - Gouverneur

28 February 2006

The Honourable James Michael Flaherty, PC, MP
Minister of Finance
140 O'Connor Street
21st Floor
Ottawa, Ontario
K1A 0G5

Dear Minister,

In accordance with the provisions of the Bank of Canada Act, I am submitting the Bank of Canada's *Annual Report* for the Year 2005 and the Bank's audited financial statements as at 31 December 2005.

Yours sincerely,

A handwritten signature in black ink, reading "D.A. Dodge".



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 quality 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



This year's cover features one of the two amphorae, or large urns, that grace the front of the Bank of Canada building on Wellington Street in Ottawa.

In antiquity, amphorae were used to store a variety of precious goods, ranging from wine and oil to coins and jewels. For this reason, they have come to symbolize the storage of wealth.

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MESSAGE FROM THE GOVERNOR

In 2005, the Bank of Canada celebrated its 70th anniversary. Since the Bank opened its doors in March 1935, it has evolved into a national institution at the heart of Canada's economy. We had a lot to celebrate in 2005—particularly our progress over the past 70 years and our continuing contribution to the economic and financial well-being of Canadians.

The preamble to the Bank of Canada Act sets out our major objectives. It reads:

... it is desirable to establish a central bank in Canada to regulate credit and currency in the best interests of the economic life of the nation, to control and protect the external value of the national monetary unit and to mitigate by its influence fluctuations in the general level of production, trade, prices and employment, so far as may be possible within the scope of monetary action, and generally to promote the economic and financial welfare of Canada.

While our country and our economy have grown and evolved considerably since 1935, the Bank of Canada's mandate continues to serve Canada and Canadians very well. How the Bank conducts its business has changed over time, but our objectives remain the same.

The Bank fulfills its mandate through its activities in four business lines: monetary policy, currency, the financial system, and funds management.

Monetary Policy

The Bank's conduct of monetary policy is key to fulfilling its mandate. Our experience, like that of other central banks around the world, has taught us that the best contribution that monetary

policy can make to strong and sustained economic growth is to keep inflation low, stable, and predictable.

In 1991, we agreed with the Government of Canada on a formal framework for targeting inflation. Since 1995, the Bank has used this framework to keep inflation at the 2 per cent midpoint of a 1 to 3 per cent range. Achieving and maintaining this target has not only kept inflation under control, it has also helped to reduce fluctuations in production and employment.

Canada's economic performance in 2005 reflects this. Our economy was running very close to its production capacity, and unemployment was at a 30-year low. Although total consumer price inflation fluctuated in response to energy shocks in 2005, underlying (or core) inflation remained close to the 2 per cent target. Inflation expectations also remained solidly anchored at 2 per cent.

Our monetary policy helps the economy to adjust to external events and remain resilient to shocks from abroad. International developments and movements in the external value of the Canadian dollar can significantly affect Canada's foreign trade and overall economic growth. Through our research and analysis, we aim to better understand the forces at work on our economy and to decide on an appropriate monetary policy response. We do this always with the aim of keeping inflation low, stable, and predictable and the economy expanding at a steady, sustainable pace.

Currency

Since 1935, the Bank of Canada has been designing and issuing Canada's bank notes. It is our responsibility to produce secure, high-quality paper currency that Canadians can use with confidence. During recent years, counterfeiting of Canadian notes has been one of our biggest challenges, as high-quality reprographic technology, such as colour photocopiers and scanners, has become widely available. As part of our strategy to protect the integrity of Canada's bank notes, we have been issuing a new series of notes with advanced security features.

We have also worked with our partners in the law-enforcement, retail, and hospitality sectors to develop a comprehensive national strategy for counterfeit deterrence. This strategy has started to pay dividends—counterfeiting levels began to decline in 2005, although they remain a challenge. We will continue to pursue and expand our anti-counterfeiting initiatives, with the help of our partners and with the support of Canadians.

Financial System

In many ways, the central bank is at the centre of Canada's financial system. In the 1950s, we provided the impetus for the development of a Canadian market for government bills, bonds, and other short-term securities. Today, we oversee the clearing and settlement systems that financial institutions use to settle their daily transactions. The Bank of Canada is also the "lender of last resort"—the ultimate provider of liquidity to the financial system.

The Bank plays a key role in improving the financial welfare of Canada, as mandated in the Bank of Canada Act, by promoting the stability and efficiency of the country's financial markets. We do this through research, analysis, and dialogue with other policy-makers and financial system participants.

The Bank promotes increased efficiency in the Canadian financial system because we know that an efficient system facilitates the allocation of

scarce resources to their most productive uses in the economy. This, in turn, helps generate higher standards of living for Canadians. An efficient financial system also helps the Bank in its conduct of monetary policy. When we set the target for the overnight interest rate eight times a year, markets and financial institutions transmit the effects of those interest rate decisions to the economy. The financial system also provides us with critical information and feedback about what is happening in the Canadian economy.

Funds Management

In addition to our responsibilities in Canada's financial system, the Bank is also the fiscal agent for the Government of Canada. In this role, we contribute to the efficient management of the federal government's finances. The Bank provides policy advice to the government and manages its cash balances and foreign exchange reserves, as



well as the issuance of Government of Canada debt instruments.

We continue to increase our research and analytic capacity in these areas, and have invested in corporate infrastructure to enhance our decision making and risk management, and to improve service.

Organization and Management

This year, we will reach the end of our 2003–06 medium-term plan, which sets out the strategic priorities needed to fulfill our policy requirements and corporate responsibilities.

Throughout 2005, the Bank continued to work at achieving the outcomes identified in the plan in the most cost-effective way. We have every reason to believe that, by the end of 2006, we will have accomplished almost all of our plan's strategic objectives.

We are now engaged in preparing our next medium-term plan and are focusing on the following challenges:

- Improving our analytic capabilities and the databases necessary for our financial system and monetary policy research;
- Assuring continuity of operations, especially for banking services;
- Investing appropriately in information technology;
- Developing more secure currency, which includes preparing for the next series of bank notes;

- Maintaining best practices in corporate governance;
- Attracting, developing, and retaining the highly skilled staff that we need in order to continue to achieve excellence.

Throughout its history, the Bank of Canada's reputation and success have always relied on the skill, dedication, and professionalism of its staff. As a public institution and as a workplace, we continue to take our bearings from our commitment to Canadians, to excellence, and to one another. I want to personally thank the Bank's employees for their outstanding work in 2005. I also want to thank the members of the Board of Directors for their continuing guidance and support.

As Canada's central bank, we will continue to be accountable to Canadians and to fulfill our mandate to promote the economic and financial welfare of this country and its citizens.



David A. Dodge



BOARD MEMBERS admire the National Capital Commission plaque located across from the Bank of Canada's head office on Ottawa's Wellington Street. This area is part of "Confederation Boulevard," a ceremonial route that runs through the heart of the Capital.

