Intervention in the Exchange market

BACKGROUNDER

The Canadian dollar, like the currencies of most industrialized nations, operates on the basis of a floating *exchange rate* which means the price of a Canadian dollar fluctuates according to market conditions.

Periods of volatility in the exchange rate can arise and the Bank of Canada may intervene in the foreign exchange markets on behalf of the federal government to counter disruptive movements in the price of the Canadian dollar.

Foreign exchange market intervention is conducted using the federal government's holdings of foreign currencies that are held in the Exchange Fund Account. The fund holds foreign reserves such as U.S. dollars, Japanese yen, European euros, as well as other assets like Special Drawing Rights (SDRs) at the International Monetary Fund (IMF), and gold. Every week, statistics are published by the Bank showing changes in the level of reserves in the fund.

The Bank acts as agent of the government of when it buys and sells foreign exchange reserves. The currencies that are purchased when Canadian dollars are sold are added to the exchange fund reserves. Net capital gains from these transactions and interest earned on these assets are reported as exchange fund earnings.

No particular level for exchange rate

The Bank does not target any particular level for the currency and believes that this should be determined by the market. Over time, market forces will ensure that the value of the Canadian dollar is equal to (or relatively close to) the real international value of our money relative to that of other countries.

When the Bank does intervene in foreign exchange markets on behalf of the federal government, it is a short-term action.

If the Bank wants to moderate a decline in the price of the Canadian dollar, it will buy dollars in foreign exchange markets in exchange for other currencies, mainly U.S. dollars. This boosts demand for Canadian dollars and helps support the dollar's value. To make sure that the Bank's purchases do not take money out of circulation and create a shortage of Canadian dollars, the Bank "sterilizes" its purchases by redepositing the same amount of Canadian dollar balances in the financial system.

Conversely, if the Bank feels the dollar's value is rising too quickly, it can sell Canadian dollars. By selling dollars, the Bank increases the supply of Canadian dollars in foreign exchange markets and this tends to moderate the rise in the value of the dollar.

In the long run, the value of the Canadian dollar is determined by economic forces such as our rate of *inflation* and Canadian *interest rates* which depend on the conduct of Canada's *monetary policy*, as well as the competitiveness of the goods we produce, and how our economy is growing.