sources in our economy. The basic reason for this is that the costs of Canadian production have risen too much relative to foreign production to permit Canadian production to be sufficiently competitive in international markets.

Foreign exchange

That situation had consequences for the foreign-exchange value of the Canadian dollar. Although there were other important contributing factors, the main reason that the Canadian dollar has declined so much in exchange markets over the past two years is that Canadian production has not been sufficiently competitive with foreign production to avoid a substantial change. One should note, however, in this context that the exchange rate for the Canadian dollar has been much weakened in recent weeks by the appearance in two consecutive months of figures on Canada's international trade that were very much weaker than had been expected. These figures recorded for the two months no significant surplus in our international trade in goods, whereas Canada needs to have large net exports of goods to offset our large net imports of services, including business and travel services and interest and dividends on our large external indebtedness. The unexpectedly weak trade figures naturally raised the question of whether Canada's competitive position in international trade was not much weaker than had been supposed, and the exchange market reacted accordingly. I myself have no doubt that when it becomes possible to assess these figures in perspective they will be found to have been quite misleading as indicators of Canada's competitive position. The situation is not nearly as bad as those figures suggest, and when in due course that emerges the exchange market will presumably react in the opposite direction.

Stability impossible with inflation

It was, in my opinion, a happy event when in the course of 1975 public policy in Canada swung from trying to learn to live with inflation to trying to learn to live without it. I have also welcomed the subsequent initiatives of the federal and provincial governments that are directed to the same end.

I would like to be as clear as possible about why I am in favour of learning to live without inflation, and opposed to trying to live with it. The reason does not lie in some arcane central banking belief in monetary stability as an end in itself but in the basic economic proposition that market societies do not and cannot function well under continuing inflationary conditions. In such circumstances they do not and cannot produce what their citizens want from them, namely, stable prosperity. If a society wants stability and prosperity it should avoid inflation like the plague. I do not claim that this proposition is self-evident but I am sure that it is true. Its truth is now strongly supported by a large and rapidly growing body of economic experience around the world.

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Monetary expansion reduction

It is, I take it, a truism that price inflation cannot continue unless it is financed by monetary expansion. That is why the Bank of Canada is following its present policy of reducing over time the rate of monetary expansion in Canada. As you know, we are doing this gradually rather than precipitately, and the reason for the gradualism is to avoid the intense economic disruption, and the social reaction, that would inevitably be involved in a deliberate precipitate change in the financial environment.

As you know, we in the Bank of Canada have been pursuing this policy of moderating gradually the rate of monetary expansion in Canada by the practice of publishing a target range for the future growth of the money supply narrowly defined (M1), and then each year or so lowering the target range. Last week we published the fourth target range in this series. The new target range is from 6 to 10 per cent annually, and it replaces a range of 7 to 11 per cent chosen last year, 8 to 12 per cent the year before and 10 to less than 15 per cent announced in the fall of 1975. We are thus making progress in reducing our target range.

Having targets is of course of limited value if one does not have some success in hitting them. I should therefore add that for each of the three periods for which we have had them we have come well within our target ranges.

That, briefly, is the story of monetary policy in Canada in the last three years and its posture for the future. We have so far managed to follow much the path for monetary expansion that we wanted to follow, and we intend to press on. We have been much encouraged by the support that our policy has received, and we hope for the continuation of that support.

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Over the past three years the path of price inflation in Canada as measured by the various price indexes has been rather erratic. The main reason for this has been the volatile course traced out by food prices both here and in the United States....

One can of course not ignore food prices or the effect of the exchange rate on prices, but if one makes allowance for them in analysis he finds that the upward pressure on prices in Canada from all other sources has moderated substantially and more or less continually over the past three years. This has arisen fundamentally from the moderation that has occurred in the rate of upward movement of labour costs. This development is cheering, for a reduced rate of inflation of Canadian costs is exactly what the country needs to strengthen the base for its future prosperity. In my opinion there is at present far too little recognition both at home and abroad of the extent and importance of the moderation that has been achieved in the underlying trend of Canadian costs. The main reason for this probably is that this favourable underlying development has been obscured for some time in the price indexes by the rising food prices and the declining exchange rate. There is, however, now a good prospect that it will soon emerge as the main determinant of the trend of Canadian prices.

The big danger in the present situation is that the recent upward surge in the consumer price index caused by foods and the exchange rate will lead to a reversal in the moderating trend of production costs in the Canadian economy....

Restraint needed now

The trouble is that a new burst of inflation of incomes will not ease the national problem, but will rather compound it. It will reverse the progress we have made in recent years towards establishing the basis for stable prosperity. Another outburst of wage and salary inflation will mean that we shall have to go through the painful sobering-up process from the beginning all over again. One must therefore devoutly hope that Canadians will find it possible to show sufficient restraint in the months ahead to avoid an acceleration of cost inflation. One must hope that they

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