

time being at least — some relief from pressure in these particular areas of production costs.

### Expenditure control

Other important adjustments that have been made in the economy include a firmer control of expenditures by governments across the country and a less rapid rate of monetary expansion. This relatively moderate rate of monetary growth has been accompanied by a decline in short-term interest rates, which are now significantly lower than [they were] a year ago. The same is true of mortgage rates. Long-term rates have also declined. Interest rates are not high now in relation to the underlying rate of inflation. Funds are readily available to creditworthy borrowers in financial markets and from financial institutions. Whether looked at in relation to our monetary targets or in relation to credit conditions, the current setting of monetary policy is not, in my view, impeding the achievement of more satisfactory levels of output and employment in Canada.

### Foreign-exchange rates

Another important adjustment that has occurred is the large decline in the foreign-exchange value of the Canadian dollar over the past 12 months. In large measure a decline of this kind was inevitable sooner or later because of the recognition in exchange markets that costs and prices inside Canada had gotten far out of line with those of our chief trading partners, particularly the United States. It is our past catching up with us. The constructive aspect of this exchange-rate adjustment is the offset it provides to the damage done in recent years to our international competitive position. The help it gives us will not last very long, however, if Canadians insist on obtaining compensating increases in rates of pay to offset the direct effect of exchange depreciation on Canadian prices. To take advantage of the degree to which it has restored our competitive position, we must strictly contain the feed-back effects of this exchange-rate depreciation on our domestic costs of production. If we fail to do so we shall be only running in circles and getting nowhere — at least nowhere that we want to go.

The combination of an improving domestic cost-and-price performance and a substantial depreciation of the Canadian dollar has gone a long way towards build-

ing a solid basis for a resumption of more satisfactory rates of growth of output and employment in Canada. I am in fact hopeful that we will see the beginning of this better performance in the course of the coming year.

### Requirements for success

For this hope to be realized various things must go right. One of them is that the economic expansion that is currently proceeding in the outside world must continue....

Another thing that must go right is a strengthening of business and consumer confidence in Canada. Confidence is usually at its lowest ebb just before economic activity finally begins to pick up, but it strengthens quickly with an upturn in activity. It is not unreasonable to expect signs of such a revival to make their appearance before long given the prospects for somewhat stronger growth in total spending and the improvement that has occurred in our competitive position....

Perhaps the major requirement on the domestic scene concerns the wage-and-price setting behaviour of Canadians in the period ahead. For the remainder of the control program, the basic guideline for pay increases has been held down to 6 per cent, and profit-margin controls will remain in effect for most firms throughout 1978. These arrangements should be of considerable help in limiting the price-and-cost impact of the decline in our exchange rate. But what will happen as controls come to an end? What will be left to keep cost increases from greatly outstripping productivity gains, and prices from rising at least proportionately? In the private sector of the economy the answer is: what there always was — the discipline of competitive market conditions and the bottom line. As we approach the decontrol period it is important that there be a widespread appreciation that this form of restraint on price-and-cost increases will be there, and that even though markets may be strengthening next year, they will not be strong enough to bear average increases in rates of pay of more than 6 per cent a year....

Naturally I am anxious that as we approach the end of controls no one should look to monetary policy to accommodate inflationary increases in costs and prices through excessive monetary expansion. There are two main ways a central bank can contribute to inflation. One is to overdo monetary expansion by sacrificing

longer-run considerations in the desire to help bring about a quick improvement in economic activity. The other is to overdo monetary expansion by accommodating passively whatever rates of inflation are generated by excessive pay and price increases. Neither does any good in the long run....

It is clear that we Canadians are going to discover the answers to some critical questions in the next year or so. We are going to find out, for example, whether we can make our relatively free market system of price and income determination work again. There are the other risks and uncertainties that I have mentioned, and more. Small wonder that there is a range of views about the likely performance of the Canadian economy in 1978....

Whether or not things work out as well as this in the Canadian economy in 1978 will depend in large measure on the response of Canadians in their wage-and-price behaviour to the current setting of public policies.

There is no doubt that we can, if we are so inclined, revert to saddling our economy with costs of production so high as to perpetuate existing unemployment levels, further erode the value of our money, and throw away the chances of achieving the degree of prosperity that a country as potentially rich as Canada ought to be able to afford its citizens.

I believe that Canadians have too much common sense and too much sense of community responsibility to respond to the challenge of the times in that way. I believe that we have all learned some painful lessons from our recent economic history, and that we are indeed making progress in overcoming our economic problems. One hears a good deal of pessimistic comment these days but I suggest that, as is often the case in economic matters, much of it is well out of date. Such pessimism would have been more appropriate a few years ago when we were really headed for trouble — for example, during the period when money incomes in Canada were increasing by as much as 15 to 20 per cent a year while increases just across the border were far smaller. How did we imagine that was going to work out?

...I believe we have come a long way back from a very dangerous situation and that we are still moving in the right direction. That's why today I count myself among the optimists about Canada's future economic prospects.