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Twenty-seven years ago today...
Charles Vincent Massey was sworn in as the Governor General of Canada – the first native-born Canadian to hold that office. He was also the first Governor General to fly over the North Pole.

Canada's monetary policy and the exchange rate

The following passages are from a statement prepared for the appearance of the Governor of the Bank of Canada, Gerald K. Bouey, before the House of Commons Standing Committee on Finance, Trade and Economic Affairs, on February 6:

The basic view on which the Bank of Canada has been operating is that any lasting improvement in the functioning of the domestic economy and in Canada's external financial position will require much greater stability in the value of money – that is, much lower rates of inflation – than Canada has experienced in recent years.

In order to help gear down inflation in Canada the Bank has for some time now been gradually moderating the trend rate of monetary expansion. Within this medium-term policy framework, the actions taken by the Bank of Canada during the course of the past 12 months gave special weight to the concern it felt about the potential inflationary impact of the movement of the foreign exchange value of the Canadian dollar. In acting as it did, the Bank was prepared to run the risk that its bank rate increases might cause the rate of monetary growth to fall somewhat below its current target range for a while – though not so far below, nor for so long a time, as to prejudice seriously either its medium-term objectives for monetary expansion or Canada's prospects for continuing economic growth. This risk has not yet materialized, although it still remains a possibility. In terms of the main indicator of money supply growth that the Bank uses – currency and demand deposits, or M1 – monetary expansion in Canada, after a temporary bulge late last year, is now running well within our current target range of 6 to 10 per cent a year, measured from a June 1978 base.

Competitive position held

The reason for concern about the speed and magnitude of the exchange-rate movement is the degree of upward pressure it is putting on Canadian costs and prices. A substantial decline in the value of the Canadian dollar relative to the United States dollar had become inevitable because of the higher rate of price and cost inflation in Canada than in the United States earlier in the 1980s. In the circumstances, a considerable exchange-rate adjustment was both necessary and desirable to help restore Canada's international competitive position. The substantial depreciation of the Canadian dollar that has now occurred, together with an improved performance to date in controlling our domestic costs, has re-established Canada's competitive position at least for the time being.

It must be a major objective to safeguard our newly-won competitive position. I need hardly point out how much there is to be gained by being strongly competitive: more exports, more import replacement, a lower current-account deficit, less dependence on foreign capital, more output, more jobs, even higher government revenues and lower government deficits than we would otherwise have. I cannot think of a more attractive way to move our economy forward. However, if we are to reap the benefits from the maintenance of this competitive position we have to be careful about putting further upward pressure on Canadian costs and prices at this time. Our costs and prices are already under unusual pressure from food prices, from catch-up attempts following the termination of Anti-Inflation Board controls and from the exchange depreciation that has already occurred. We must not allow this pressure to become intolerable and thereby set off a renewed acceleration of inflation with leap-frogging price increases and wage settlements. We must not follow the example of countries that have fallen into a vicious circle of inflation, then depreciation, then more inflation and so on. It is to avoid this danger and to keep the rate of price

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