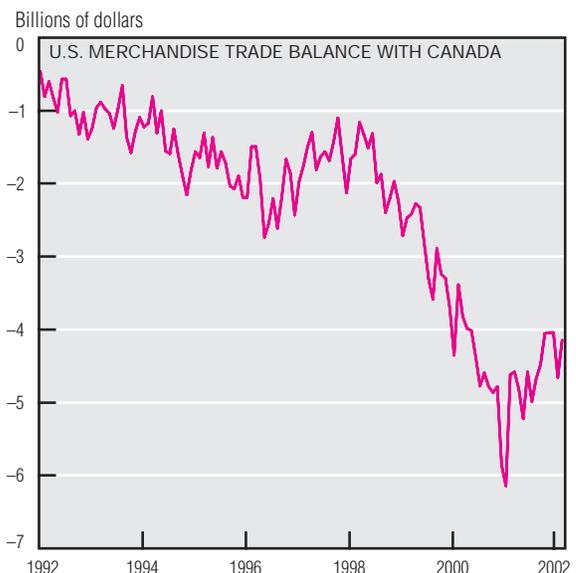
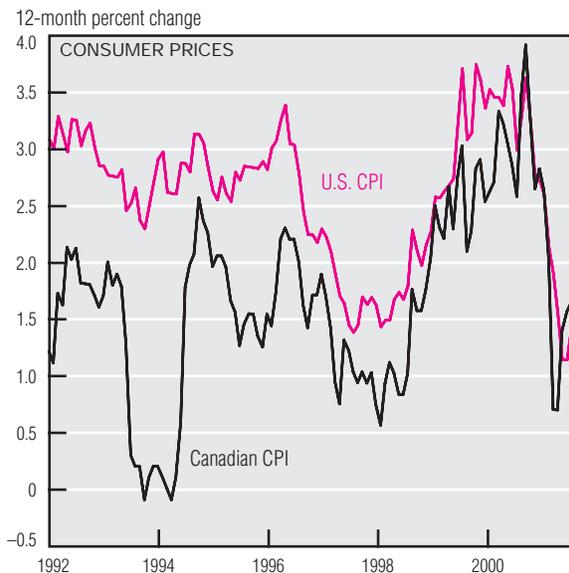


The Canadian Dollar



SOURCES: U.S. Department of Commerce, Bureau of the Census and Bureau of Economic Analysis; U.S. Department of Labor, Bureau of Labor Statistics; Board of Governors of the Federal Reserve System; and Bank of Canada.

With the Canadian recovery gathering steam, the Canadian dollar has strengthened against the U.S. dollar during the last few weeks. Canadian three-month interest rates have risen above U.S. rates, a result of both the economic recovery and the Bank of Canada's decision to increase overnight rates—presumably a response to strength in Canadian domestic demand. Because the U.S. federal funds rate has remained constant recently, the increase in the Canadian rate has boosted the differential between Canadian and U.S.

short-term rates, supporting an immediate upward movement in the value of the Canadian dollar.

Consumer price inflation remains subdued in both countries, although core inflation in Canada rose a bit in February, which may have encouraged the rate increase. A major difference between the two countries is the quicker pace of economic recovery in Canada. In both countries, improvement in business investment will be a key factor in the coming months.

Although Canada's economy is heavily influenced by the U.S., the

value of its currency is determined in global financial markets. There is only a weak correspondence between the bilateral, U.S.–Canada trade balance and the exchange rate between the two countries. Since 1992, the Canadian dollar has generally been weakening against the U.S. currency, although the U.S. has been running a trade deficit with Canada. Canada has a trade surplus with the rest of the world, providing a net stimulus to its economy.