David Dodge: Summary of the latest Monetary Policy Report

Opening statement by Mr David Dodge, Governor of the Bank of Canada, at a press conference following the release of the Monetary Policy Report Update, Ottawa, 22 January 2004.

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Today, we released our *Update* to the October *Monetary Policy Report*. The *Update* reviews economic and financial trends in the context of Canada's inflation-control strategy.

Three developments have led us to modify our outlook for economic growth and inflation in Canada, since our October *Monetary Policy Report*. These include: stronger-than-expected world economic activity, the continued sharp depreciation of the U.S. dollar against major world currencies (including the Canadian dollar), and a somewhat larger output gap in Canada at the end of 2003. Weighing these developments and their likely persistence, we lowered our projection of output in Canada over the next year and a half. In this context, we cut policy interest rates to support aggregate demand and thus return inflation to 2 per cent over the medium term.

In Canada, economic growth in the period ahead will need to come primarily from private domestic demand, supported by monetary stimulus and by strong business confidence. We now project growth to average about 2 3/4 per cent in 2004, and to pick up to about 3 3/4 per cent in 2005. This would imply that the output gap would not change materially before the end of 2004, but would be substantially closed by the third quarter of 2005.

We project that core inflation will fall below 1 1/2 per cent in early 2004, before gradually moving back to the 2 per cent target by the end of 2005. Total CPI inflation should remain below core inflation through 2005 if oil prices ease gradually from their current levels.

The main uncertainties in the outlook relate to the adjustment of the Canadian economy to global changes. Canadian monetary policy facilitates the overall adjustment process by helping to sustain aggregate demand in Canada.