David Dodge: Recent review of the Canadian economy

Opening statement by Mr David Dodge, Governor of the Bank of Canada, to the Senate Banking, Trade and Commerce Committee, Ottawa, 20 April 2004.

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Good morning, Mr. Chairman and members of the Committee. As always, we appreciate the opportunity to meet with you twice a year, following the release of our *Monetary Policy Report*. These meetings help us keep Senators and all Canadians informed about the Bank's views on the economy and about the goal of monetary policy and the actions we take to achieve it.

The Canadian economy continues to adjust to developments in the global economy such as stronger world demand, higher commodity prices, and the realignment of world currencies, including the Canadian dollar. Emerging-market economies, especially China and India, are contributing to intensified competition but are also creating new trading opportunities for Canada.

These developments require shifts in activity among sectors and create a need for adjustments by many businesses. Monetary policy is facilitating these adjustments by supporting aggregate demand, with the goal of keeping the economy near its full production potential and inflation on target.

When Paul and I appeared before this Committee last October, we told you that economic growth in Canada was weaker than expected and that there was more slack in the economy than we had projected six months earlier. As you know, the Canadian economy was affected by a number of shocks in 2003. Thus, despite a broadening of the global economic recovery and higher commodity prices, it turned out that the economy at the end of the year was operating well below the level that we had projected in our October *Report*.

Preliminary indications are that growth in the first quarter of this year was marginally below 3 per cent. Thus, the Bank's view is that the economy is still operating significantly below its potential.

Our outlook for economic growth and inflation is essentially unchanged from that of the January *Monetary Policy Report Update*. The economy is expected to grow by about 2 3/4 per cent in 2004, picking up to about 3 3/4 per cent in 2005. This stronger growth is expected to come from private domestic demand, reflecting the current monetary stimulus in the economy and high levels of business and consumer confidence. Such growth would return the economy to close to its production potential by the third quarter of 2005. Core inflation - which removes the most volatile components of the consumer price index and the impact of indirect taxes on the remaining components - should average 1 1/2 per cent over the remainder of this year. As excess supply in the economy diminishes, core inflation is expected to move back to 2 per cent by the end of 2005.

The main uncertainty for the outlook continues to relate to how the Canadian economy adjusts to global developments. Overall, the risks to the outlook appear balanced.

Mr. Chairman, Paul and I will now be glad to answer the Committee's questions.