David Dodge: Views on the Canadian economy and monetary policy

Opening statement by Mr David Dodge, Governor of the Bank of Canada, to the Standing Senate Committee on Banking, Trade and Commerce, Ottawa, 3 May 2006.

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

When Paul and I appeared before this Committee last October, we said that the global and Canadian economies were continuing to grow at a solid pace, that our economy appeared to be operating at full production capacity, and that it would remain at capacity in 2006 and 2007. Total and core inflation were projected to average close to 2 per cent, beginning in the second half of this year. This projection assumed oil prices at roughly US$64 per barrel, a level then indicated by futures prices. Our projection also assumed stable commodity prices, government spending that was growing roughly in line with revenues, and a Canadian dollar continuing to trade in a range of 85 to 87 cents U.S.

In our April *Monetary Policy Report* (*MPR*), we say that the global economy has shown a little more momentum than had been anticipated: oil prices have been roughly US$10 per barrel higher than assumed; metals prices have risen significantly; and the Canadian dollar had been trading in a range of 85 1/2 to 88 ½ cents U.S.

In our *Report*, the Bank projects economic growth of 3.1 per cent in 2006, 3.0 per cent in 2007, and 2.9 per cent in 2008. Total CPI inflation will continue to be volatile and affected by developments in the markets for crude oil and natural gas, and will average close to 2 per cent in 2007 and 2008 (excluding the effect of any changes in the GST). Core inflation is projected to rise to 2 per cent in the second half of this year and remain there through to the end of 2008.

This projection is based on three key assumptions: first, that energy prices will remain roughly as indicated by futures prices; second, that Canadian governments will continue to run budgets that are roughly in balance; and third, that the orderly resolution of global imbalances will involve a gradual depreciation of the U.S. real effective exchange rate. A small fraction of this depreciation will be against the Canadian dollar and will occur late in the projection period.

There are both upside and downside risks to the Bank's projection for growth and inflation. The Bank judges that these risks are roughly balanced, with a small tilt to the downside later in the projection period, related to a possible disorderly correction of global imbalances. We consider this risk to be slightly smaller than previously judged, given the tentative signs of policy adjustments in some countries and of rotation in global demand.

In line with the Bank's outlook for the Canadian economy and its current assessment of risks, some modest further increase in the policy interest rate may be required to keep aggregate supply and demand in balance and inflation on target over the medium term. We will closely monitor evolving economic developments in the Canadian economy in light of the cumulative increase in the policy interest rate since last September.

Mr. Chairman, I want to emphasize that what we have laid out in our April *MPR* is a projection for growth and inflation based on the assumptions that I have noted above. We publish our projection so that Canadians and financial markets know the basis against which the Bank judges all new economic developments. When we set our policy interest rate eight times a year, we assess all available information on the global and Canadian economies relative to our base-case projection and then make our monetary policy decisions.