David Dodge: Summary of the latest Monetary Policy Report

Opening statement by Mr David Dodge, Governor of the Bank of Canada, to the Senate Banking, Trade and Commerce Committee, Ottawa, Ontario, 25 October 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 May, shortly after the release of our spring *Monetary Policy Report*, we noted that the global economy had shown a little more momentum than had been anticipated: oil prices at that time were higher than previously assumed and metals prices had risen significantly. At that point, we were anticipating economic growth of about 3.1 per cent this year, 3.0 per cent in 2007, and 2.9 per cent in 2008.

Things have changed somewhat since then. While global economic growth is expected to be a little higher than anticipated last spring, a weaker near-term outlook for the U.S. economy has curbed the near-term prospects for Canadian exports and growth.

The Bank's outlook for growth in the Canadian economy has been revised down slightly from the outlook in last April's *Monetary Policy Report* and the July *Update* of that report. The Bank's base-case projection now calls for average annual GDP growth of 2.8 per cent in 2006, 2.5 per cent in 2007, and a return to 2.8 per cent in 2008. Weakness in labour productivity growth has led the Bank to lower its assumption for potential growth to 2.8 per cent for the 2006-08 period. Together, these factors imply that the small amount of excess demand now in the economy will be eliminated by mid-2007.

Core inflation is expected to remain a bit above 2 per cent in the coming months but return to the 2 per cent target by the middle of 2007 and remain there through to the end of 2008. Lower energy prices have led to a downward revision of the near-term projection for total CPI inflation. Total inflation (which includes the temporary impact of the GST reduction) will likely average about 1 1/2 per cent through the second quarter of 2007 before returning to the 2 per cent target and remaining there through to the end of 2008.

As we noted at the time of our 6 September interest rate announcement, the risks around the base-case projection are judged to be a little greater than at the time of the July *Update*. The main upside risk relates to the momentum in household spending and housing prices, while the main downside risk is that the U.S. economy could slow more sharply than expected, leading to lower Canadian exports. The Bank judges that the risks to its inflation projection are roughly balanced.

On 17 October, we left our key policy rate unchanged at 4.25 per cent. The current level is judged, at this time, to be consistent with achieving the inflation target over the medium term. The Bank will continue to pay close attention to the evolution of risks, as well as to economic and financial developments in the Canadian and global economies.