David Dodge: Monetary policy report update

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, 12 July 2007.

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Today, we released the July update to our *Monetary Policy Report*, which discusses current economic and financial trends in the context of Canada's inflation-control strategy.

Economic growth and inflation in Canada in the first half of this year have been stronger than was expected in the April *Monetary Policy Report*. The Bank judges that the economy is now operating further above its production potential than was projected in April.

The Canadian economy is now projected to grow somewhat more strongly in 2007 and somewhat more slowly in 2008 and 2009 than we previously projected. Higher interest rates across the yield curve and a stronger Canadian dollar are expected to bring aggregate demand and supply in Canada back into balance in 2009.

Inflation is projected to be slightly higher and more persistent than in the April *Report*. With the direct effect of the GST cut ending, and with the impact of the temporary decrease in gasoline prices in late 2006, total inflation is expected to peak at about 3 per cent in the fourth quarter of this year. However, as excess demand diminishes, total CPI and core inflation should decline to 2 per cent by early 2009.

The main upside risk to the Bank's inflation projection is that household demand in Canada could be stronger than projected. Higher levels of household borrowing and broad money growth point to this risk. On the downside, the adjustment in the Canadian economy to the rapid appreciation of the Canadian dollar may dampen demand for Canadian goods and services and reduce inflationary pressures more than projected. As well, the ongoing adjustment in the U.S. housing sector could be more prolonged. In the context of our new projection, the upside and downside risks appear to be roughly balanced.

On Tuesday, the Bank raised its key policy interest rate by one-quarter of one percentage point to 4 1/2 per cent, and we said that some modest further increase in the overnight rate may be required to bring inflation back to the target over the medium term.

Paul and I would now be happy to take your questions.