Mark Carney: Summary of the latest Monetary Policy Report

Opening statement by Mr Mark Carney, Governor of the Bank of Canada, at a press conference following the release of the Monetary Policy Report Update, Ottawa, 17 July 2008.

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Good morning. We are pleased to be here with you today to discuss the July *Monetary Policy Report Update*, which we published this morning.

In the *Update*, the Bank described three major developments affecting the Canadian economy: protracted weakness in the U.S. economy, ongoing turbulence in global financial markets, and sharp increases in certain commodity prices, particularly energy. While the first two of these developments are evolving roughly in line with expectations, many commodity prices continue to outpace earlier expectations, which has altered the outlook for global and domestic inflation.

Although economic growth in Canada in the first quarter of 2008 was weaker than expected, final domestic demand – supported by strong terms of trade – continued to expand at a solid pace. The Canadian economy is judged to have moved into slight excess supply in the second quarter of 2008, and this excess supply is expected to increase through the balance of the year. High terms of trade, accommodative monetary policy, and a gradual recovery in the U.S. economy are expected to generate above-potential economic growth starting early next year. This will bring the economy back to full capacity around mid-2010.

Assuming energy prices follow current futures prices, total CPI inflation is projected to rise temporarily above 4 per cent, peaking in the first quarter of 2009. As energy prices stabilize, and with medium-term inflation expectations remaining well anchored, total inflation is projected to converge to the core rate of inflation, at the 2 per cent target, in the second half of 2009. Core inflation is projected to remain well contained.

The three major developments affecting the Canadian economy pose significant upside and downside risks to our projection. On the upside, domestic demand could be greater than projected, given the strength of Canada's terms of trade and the momentum of household credit growth. Potential output could be lower than assumed, given ongoing weakness in labour productivity. Global inflationary pressures could also lead to higher-than-projected import costs for Canada. On the downside, commodity prices could be weaker than assumed. Growth in the U.S. economy could also be weaker than expected, particularly in those sectors that are most relevant for Canadian exports. As well, continued strains in global financial markets could have a greater-than-projected impact on global growth and on the cost and availability of credit in Canada. Weighing the implications of these considerations, the Bank views the risks to its projection for inflation as balanced.

Against this backdrop, the Bank judges that the current level of the target for the overnight rate – 3 per cent – remains appropriate. We will continue to monitor carefully the evolution of risks, together with economic and financial developments in the Canadian and global economies, and set monetary policy consistent with achieving the 2 per cent inflation target over the medium term.