David Dodge: Economic and financial trends in Canada

Opening statement by Mr David Dodge, Governor of the Bank of Canada, to the House of Commons Finance Committee, Ottawa, 26 October 2004.

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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 Members of Parliament and, through you, 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.

Since we last met, we are pleased to have issued Canada's new $20 bank note with enhanced security features. The new note began circulating on 29 September.

Last Thursday, we released our October *Monetary Policy Report*, which reviews economic and financial trends in the context of Canada's inflation-control strategy.

When Paul and I appeared before this Committee last April, we told you that the economy was judged to be operating significantly below its potential. That is no longer the case, because the Canadian economy has grown faster than was projected in last April's *Monetary Policy Report* and the July *Update*. This stronger growth was largely due to a surge in exports. The economy is now operating near its production capacity and continues to adjust to global economic developments.

The Bank's base-case projection for the period to the end of 2006 calls for aggregate demand for Canadian goods and services to expand, on average, at about the same rate as potential output. Given the effects of higher oil prices and the past appreciation of the Canadian dollar, the Bank projects economic growth to be slightly less than 3 per cent in 2005, and slightly more than 3 per cent in 2006.

With the economy expected to remain near its production capacity throughout this period, core inflation is projected to move back up to the 2 per cent target by the end of 2005. That is the same projection that we made last April. However, given the path suggested by futures prices for crude oil, the Bank expects total CPI inflation will rise to the top of the 1 to 3 per cent target range in the first half of 2005, before falling slightly below core inflation in early 2006.

Against this background, the Bank raised its target for the overnight rate to 2.5 per cent on 19 October. The base-case projection assumes further reduction of monetary stimulus over time, to keep the economy near its production potential and to achieve the inflation target. I want to emphasize that the pace of interest rate increases will depend on the Bank's continuing assessment of the prospects for factors that affect pressures on capacity and, hence, inflation.

There are significant risks and uncertainties around this base-case projection, related to the adjustment to changes in the global economy, including changes in commodity prices and exchange rates. The risks surrounding global economic prospects relate primarily to the evolution of oil prices, the pace of expansion in China, the way in which current account imbalances in the United States and East Asia will be resolved, and geopolitical developments.