# David Dodge: Recent review of the Canadian economy

Opening statement by Mr David Dodge, Governor of the Bank of Canada, to the Senate Committee on Banking, Trade and Commerce, Ottawa, 24 November 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 Parliamentarians 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.

When Paul and I appeared before this Committee last April, we told you that we judged the economy to be operating significantly below its potential. That is no longer the case. The Canadian economy grew faster in the first half of the year than we had projected, largely because of a surge in exports. The economy is now operating near its production capacity and continues to adjust to global developments.

Our latest *Monetary Policy Report*, released on 21 October, presents the Bank's base-case projection for the period to the end of 2006. It 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, economic growth in the *Report* is projected 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 from the current level of 1.4 per cent to the 2 per cent target by the end of 2005. This is essentially the same projection that we made last April. However, in October we expected that total CPI inflation would rise to near 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. This projection incorporates the path suggested by futures prices for crude oil in mid-October, when we finalized the *Report*.

It is against that background, that the Bank raised the target for the overnight rate to 2.5 per cent on 19 October, our most recent fixed announcement date. The base-case projection in our October *Report* assumes further reduction of monetary stimulus over time, to keep the economy near its production potential and to achieve the inflation target. We also emphasized 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, on inflation.

Paul and I have just returned from last weekend's meeting of the G-20 in Berlin. The issues we discussed there line up very closely with those issues we identified and analyzed in our *Report* - commodity prices, realignment of currencies, global imbalances, and the growing presence of emerging-market economies such as China and India.

While we remain broadly comfortable with the global growth scenario we outlined in our *Report*, discussions this weekend and at other recent international meetings suggest a slight moderation in global growth prospects, despite the fact that both spot and futures prices for oil have declined somewhat during the past month.

Since the October *Report*, one of the most significant developments has been a further depreciation of about 5 per cent in the value of the U.S. dollar against other major floating currencies, including the Canadian dollar. If current exchange rates were to be sustained - and if all other economic and financial factors were to remain unchanged - this would have a dampening effect on aggregate demand for Canadian goods and services. Since monetary policy aims to keep aggregate demand and supply in balance in order to keep inflation close to our target, we need to assess the implications of movements in the currency for aggregate demand and the context in which they occur - that is, the changes in other economic and financial factors.

In conclusion, I want to stress that the Bank assesses the full set of information before each of its fixed announcement dates, and we will do so again before our 7 December announcement.

Mr. Chairman, Paul and I now will be happy to answer your questions.