David Dodge: Recent review of the Canadian economy

Opening statement by Mr David Dodge, Governor of the Bank of Canada, to the House of Commons Finance Committee, Ottawa, 19 April 2005.

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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.

Last Thursday, we released our April *Monetary Policy Report*. In the report, we said that the global economy has been unfolding largely as expected, and the outlook for the Canadian economy is essentially unchanged from that in January's *Monetary Policy Report Update*.

The Canadian economy continues to adjust to global economic developments. This was also an important theme last October when Paul and I appeared before this Committee. These developments include the realignment of currencies in response to global imbalances, the higher prices of both energy and non-energy commodities, and growing competition from emerging-market economies.

In Canada, we are seeing more evidence of sectoral adjustments to these global developments. Many Canadian commodity-producing sectors are expanding. However, firms in some other sectors that are exposed to international trade are facing pressure from the appreciation of the Canadian dollar and from foreign competition. On balance, net exports have been a drag on the economy. But with robust domestic demand, some sectors - such as retail, wholesale, and housing - have been growing strongly.

The Bank expects Canada's economy to grow by about 2 1/2 per cent in 2005 and 3 1/4 per cent in 2006, with growth this year and next coming primarily from strength in domestic demand. To continue to support aggregate demand, we decided to leave the target for the overnight rate unchanged at 2.5 per cent on 12 April.

The Bank continues to judge that the economy is operating slightly below its production capacity, and we expect that it will move back to full capacity in the second half of 2006. Core inflation is projected to return to 2 per cent around the end of 2006. Based on the scenario implied by oil-price futures, total CPI inflation is expected to remain slightly above 2 per cent this year, and to move slightly below 2 per cent in the second half of 2006. In line with this outlook for growth and inflation, a reduction of monetary stimulus will be required over time.

This outlook is subject to both upside and downside risks and to uncertainties. The risks include the pace of expansion in Asia and the prices of oil and non-energy commodities. A further risk relates to the resolution of global current account imbalances. Should these imbalances persist, the risk of a disorderly correction would grow over time. Most of the uncertainties with respect to the Canadian outlook relate to how the economy is adjusting to the relative price changes associated with major global developments.

Monetary policy continues to facilitate the adjustment process by aiming to keep inflation at the 2 per cent target and the economy operating near its production capacity.

Mr. Chairman, Paul and I now will be happy to answer the committee's questions.