David Dodge: Monetary policy report

Speech by Mr David Dodge, Governor of the Bank of Canada, at a press conference following the release of the Monetary policy report, Ottawa, 20 October 2005.

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This morning, we released our October *Monetary Policy Report*. In the report, we said that the global and Canadian economies have continued to grow at a solid pace, and our economy now appears to be operating at full production capacity. Past and recent movements in energy prices and in the exchange rate for the Canadian dollar, along with competitive pressures from China and other newly industrialized economies, are giving rise to significant ongoing adjustments in the Canadian economy. Given these adjustments and the slow growth of productivity in recent years, the Bank has slightly reduced its estimate of potential output growth for 2005 and 2006.

The Bank projects that the economy will grow in line with production potential through 2007, with growth averaging 2.8 per cent this year, 2.9 per cent in 2006, and 3.0 per cent in 2007.

With the economy operating at capacity and with higher energy prices, pressures on consumer prices are somewhat stronger than they were at the time of the July *Monetary Policy Report Update*. Assuming energy prices evolve in line with currently prevailing futures prices, CPI inflation is projected to average near 3 per cent through the middle of 2006, before returning to the 2 per cent target in the second half of next year. Core inflation should remain below 2 per cent in coming months, returning to 2 per cent by mid-2006.

The Bank raised its key policy interest rate to 3 per cent on 18 October. In line with our outlook, some further reduction of monetary stimulus will be required to maintain a balance between aggregate supply and demand over the next four to six quarters, and to keep inflation on target. Short-term risks to this projection appear to be balanced. But as we look further out to 2007 and beyond, we see increasing risks that the unwinding of global economic imbalances could involve a period of weak world economic growth.

The Bank will continue to assess the adjustments and underlying trends in the Canadian economy, as well as the balance of risks, as it conducts monetary policy to keep inflation on target over the medium term.