David Dodge: Summary of the latest Monetary Policy Report Update

Opening statement by Mr David Dodge, Governor of the Bank of Canada, at a press conference following the release of the Monetary Policy Report Update, Ottawa, 24 January 2008.

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Good morning. I'm pleased to be here with you today, for my final press conference as Governor of the Bank of Canada, to discuss our January *Monetary Policy Report Update*.

The Canadian economy continues to operate above its production capacity, despite some slowing in growth and inflation in the fourth quarter of 2007. Financial conditions have deteriorated since October, leading to tighter credit conditions in industrialized countries. Given this, and a deeper and more prolonged decline in the U.S. housing sector, the outlook for the U.S. economy in 2008 is now significantly weaker than at the time of the October *MPR*.

The weaker U.S. economy will lead to additional downward pressure on Canada's export growth. Despite tighter credit conditions, domestic demand in Canada is expected to remain strong, supported by continued income growth associated with the increase in commodity prices seen since October. Overall, the Bank now projects that the Canadian economy will expand by 1.8 per cent in 2008 and 2.8 per cent in 2009. This growth profile implies that the economy will move into excess supply in the second quarter of this year, and then return to balance in early 2010.

Inflation is projected to fall below 1 1/2 per cent by the middle of this year before returning to 2 per cent by the end of 2009. This reflects a price-level adjustment related to increased competitive pressures in the retail sector stemming from the level of the Canadian dollar, as well as the recent reduction in the GST. Excluding the impact of the GST reduction, total CPI inflation is projected to average close to the 2 per cent target throughout 2008 and 2009.

Of course, there are a number of upside and downside risks to the Bank's base-case projection for inflation. But overall, we judge these risks to be roughly balanced.

On 4 December and on 22 January, the Bank lowered its target for the overnight rate by one-quarter of one percentage point, bringing it to 4 per cent. Further monetary stimulus is likely to be required in the near term to keep aggregate supply and demand in balance, and to return inflation to target over the medium term.