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Canadian Mortgage News - National Archive 2002

Bank of Canada releases its October *Monetary Policy Report*

OTTAWA, Ontario, October 23, 2002 Today, the Bank of Canada released its October *Monetary Policy Report*, in which it discusses economic and financial trends in the context of Canada's inflation-control strategy.

The Canadian economy has been expanding strongly so far this year and is now operating fairly close to its full production capacity. Consumer price inflation has risen above the 2 per cent target and is expected to rise further before year-end because of high oil prices and a number of other relative price movements. What is important for monetary policy is that these one-off influences on specific prices not feed more generally into price and wage inflation.

The Canadian economy has grown more rapidly than those of all other G-7 countries over the past year. Annualized growth exceeded 5 per cent in the first half of 2002—well above the growth of the economy's potential. We estimate that Canada's economy grew at an annualized rate of about 4 per cent in the third quarter. Thus, there has been a significant reduction in the amount of excess supply in the economy so far this year.

Looking ahead, global economic, financial, and geopolitical uncertainties are likely to moderate the rate of Canada's economic growth over the next three quarters. Growth should come in at the bottom of, or slightly below, the 3 to 4 per cent range that we anticipated in the last *Update*.

The output gap is very small. Assuming the uncertainties now clouding the outlook dissipate in the second half of next year, we expect growth to accelerate to above potential at that time, absorbing the remaining small amount of excess supply.

The Bank's core measure of inflation is running above our earlier projections. This largely reflects sharp increases in home and auto insurance premiums and, in Ontario, electricity prices. Core inflation is also being pushed up by strong demand for housing.

All told, core inflation is expected to peak at about 3 per cent by the end of this year. But, as the one-time influences fade, core inflation is expected to decline in the second half of 2003, provided those one-time factors do not feed into price and wage inflation more generally.

The Canadian economy is now operating not far from its capacity. In order to sustain non-inflationary growth, we will need to continue to remove monetary stimulus before the excess supply in the economy is completely absorbed. The pace and extent of this action will depend on the balance of domestic and external developments and on their implications for pressures on capacity and inflation in Canada.

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