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Canadian Mortgage News - National Archive 2007

Bank of Canada keeps target for the overnight rate at 4 1/2 per cent

OTTAWA , Ontario, October 16, 2007 — The Bank of Canada today announced that it is maintaining its target for the overnight rate at 4 1/2 per cent. The operating band for the overnight rate is unchanged, and the Bank Rate remains at 4 3/4 per cent.

Against a backdrop of robust global economic expansion and strong commodity prices, information received since the July *Monetary Policy Report Update* (*MPRU*) indicates that the Canadian economy is now operating further above its production potential than had been previously expected. The core rate of inflation, which has been above 2 per cent for the past year, was 2.2 per cent in August. Total consumer price inflation fell temporarily in August to 1.7 per cent, having been above the 2 per cent inflation target since the spring.

Since the July *MPRU*, the outlook for the U.S. economy has weakened because of greater-than-expected slowing in the housing sector. The Bank has revised down its projection for U.S. growth to 1.9 per cent in 2007 and 2.1 per cent in 2008. U.S. growth is expected to pick up to 3 per cent in 2009.

The Canadian dollar traded in a range of 93 to 95.5 cents U.S. in July and August, but since then it has appreciated sharply to as high as 1.03 dollars U.S. In the Bank's new base-case projection, the Canadian dollar is assumed to average 98 cents, the mid-point of the range since the July *MPRU*. As well, there has been a tightening of credit conditions stemming from the financial market developments this summer. For Canada, the Bank assumes that the cost of credit for firms and households relative to the overnight rate will be 25 basis points higher over the projection period than it was prior to the summer developments.

Despite these tighter credit conditions, momentum in domestic demand in Canada is expected to remain strong. The combined effect of a weaker U.S. outlook and a higher assumed level of the Canadian dollar implies, however, that net exports will exert a more significant drag on the economy in 2008 and 2009 than previously expected. As a result, the Canadian economy is projected to grow by 2.6 per cent in 2007, 2.3 per cent in 2008, and 2.5 per cent in 2009. This growth profile implies that aggregate supply and demand will move back into balance in early 2009. Both core and total CPI inflation are projected to return to 2 per cent in the second half of 2008.

In line with this projection, the Bank judges, at this time, that the current level of the target for the overnight rate is consistent with achieving the inflation target over the medium term.

There are significant upside and downside risks to the Bank's inflation projection. On the upside, excess demand in the Canadian economy could persist longer than projected. This could come from two sources: higher growth in household spending than projected and lower growth in productivity than assumed. On the downside, if the Canadian dollar exchange rate were to persist above the 98 cent U.S. level assumed over the projection horizon for reasons not associated with stronger-than-projected demand for Canadian products, Canadian output and inflation would be lower. In addition, the effect of the past appreciation of the Canadian dollar on demand and inflation could be stronger than expected and the effect of the weakness in the U.S. housing sector could be greater than anticipated. All factors considered, the Bank judges that the risks to its inflation projection are roughly balanced, with perhaps a slight tilt to the downside.

A full update of the Bank's outlook for growth and inflation will be set out in the *Monetary Policy Report*, to be published on 18 October 2007.

Information note:
The Bank of Canada's next scheduled date for announcing the overnight rate target is 4 December 2007.