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Bank of Canada releases Monetary Policy Report

OTTAWA , British Columbia, October 18, 2007 — The Bank of Canada today released its October *Monetary Policy Report*, which discusses current economic and financial trends in the context of Canada's inflation-control strategy.

There have been a number of significant economic and financial developments since the July *Monetary Policy Report Update*. Against a backdrop of robust global economic expansion and strong commodity prices, the Canadian economy has been stronger than projected and is now operating further above its production potential than had been previously expected.

Since the July *Update*, the outlook for the U.S. economy has weakened. The Canadian dollar has appreciated sharply, and credit conditions have tightened. Despite these tighter credit conditions, the momentum of domestic demand in Canada is expected to remain strong. The combined effect of a weaker U.S. outlook and a higher assumed level for 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, Canada's gross domestic product is projected to grow by 2.6 per cent in 2007, 2.3 per cent in 2008, and 2.5 per cent in 2009.

With the economy moving back towards balance, and with the direct effect of the stronger Canadian dollar on consumer prices, core inflation is projected to gradually decline to 2 per cent in the second half of 2008. Total CPI inflation is expected to peak at about 3 per cent later this year and then move back down to the 2 per cent target in the second half of 2008.

But there are a number of upside and downside risks to the Bank's inflation projection. The main upside risk is that excess demand in the Canadian economy could persist longer than projected. The main downside risk is that output and inflation could be lower if the Canadian dollar were to be persistently higher than the assumed average level of 98 cents U.S. for reasons not associated with demand for Canadian products.

All factors considered, the Bank judges that the risks to its inflation projection are roughly balanced, with perhaps a slight tilt to the downside.

Against this backdrop, the Bank left its key policy rate unchanged on 5 September and 16 October at 4.50 per cent. 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.