BANK OF CANADA

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Bank of Canada releases semi-annual *Monetary Policy Report*

The Bank of Canada today released its twelfth semi-annual *Monetary Policy Report* in which it discusses economic and financial trends in the context of Canada's inflation-control strategy. The *Monetary Policy Report* is published every May and November.

The Bank reports that the Canadian economy has continued to expand briskly, outstripping expectations. Despite this robust growth, core inflation has remained lower than expected.

The global economy is showing strong momentum. While demand in the U.S. economy remains robust, recent data indicate that overall growth has slowed. Many emerging markets have continued to recover from the 1997–98 financial crisis. In Europe, growth is expected to remain solid in coming quarters. The Japanese economy, although still fragile, is improving.

The Bank of Canada is currently projecting economic growth of close to 5 per cent for 2000. This reflects the upward revision to Canada's GDP in the second half of 1999 and the robust performance in the first half of this year. For 2001, the Bank expects growth to slow to a range of 3 to 4 per cent, primarily reflecting the expected slowdown in the U.S. economy. While there are signs that the Canadian economy has begun to slow, the momentum of demand will increase pressures on production capacity. As a result, core inflation is expected to rise to the 2 per cent midpoint of the Bank's inflation-control target range in the second half of 2001. If oil prices were to stabilize at levels just below US$30 a barrel, the rate of increase in the total CPI would be expected to move down to about 2 per cent by the end of 2001.

The main risks to this outlook revolve around demand, supply, and inflation expectations. On the demand side, continued robust growth in U.S. demand for Canadian exports could increase inflation pressures here. On the supply side, brisk spending on machinery and equipment, combined with recent productivity gains, may raise capacity limits beyond projected levels. However, the Bank will continue to take a cautious approach to projecting potential output, updating its estimates as evidence accumulates. Higher energy prices may feed into the prices of other goods and services and into expectations of future inflation.

The challenge for monetary policy will be to carefully assess the balance between aggregate demand and supply in the economy and to guard against the risk that higher energy prices could affect core inflation and inflation expectations. The Bank must be prepared to adjust monetary conditions in a timely manner to preserve the low trend of inflation that has been benefiting the Canadian economy.