BANK OF CANADA

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Monetary Policy Protects Canada from Persistent Inflation and Deflation, Governor Says

TORONTO—In a speech to the Speakers Forum, Bank of Canada Governor David Dodge said today that Canada's macroeconomic policy framework is protecting the economy from both persistently high inflation and the threat of deflation.

Mr. Dodge said that recent rates of inflation in Canada have been higher than expected. At the same time, other countries are seeing weak demand and declines in some goods prices, which has triggered fears of deflation.

"We aim to keep the trend of (Canada's) consumer price inflation at the 2 per cent midpoint of a 1 to 3 per cent range," Mr. Dodge said. "Let me assure you that the Bank of Canada will continue to pursue a monetary policy focused on returning inflation to that 2 per cent target, should it deviate in either direction." The Bank will be acting to prevent the current high inflation rates from feeding into inflation expectations and will also be assessing all measures of capacity pressures in the economy, he added.

"Let's remember that the stance of monetary policy remains stimulative," the Governor said. "To return inflation to the 2 per cent target over the medium term, we will need to remove some of the stimulus. In other words, we will need to raise interest rates."

The Governor said that Canada's economic prospects are still being influenced by foreign developments. Risk premiums in financial markets are expected to continue to decline, improving the climate for business investment. But the possible outbreak of war in the Middle East remains the great geopolitical uncertainty.

The Bank expects growth below the economy's potential in the first half of 2003, but demand pressures are expected to increase in the second half and into 2004, as global uncertainties diminish. Inflation is expected to remain well above the 2 per cent target in the first half of 2003, primarily because of certain one-off factors. But in the second half of the year and into 2004, core inflation should ease, as the effects of those one-off factors diminish and as appropriate monetary policy action keeps demand pressures in check.