



BANK OF CANADA

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CONTACT: Annie Portelance
(613) 782-8782

Bank of Canada releases *Monetary Policy Report Update*

The Bank of Canada today released its *Update* to the April *Monetary Policy Report*. The *Update* discusses current economic and financial trends in the context of Canada's inflation-control strategy.

Since the April *Report*, three developments have led to small modifications in the Bank's outlook for economic growth and inflation in Canada. First, growth in the first half of 2004 is now estimated to be somewhat higher than was projected in April. Combined with a small upward revision to GDP data for 2003, this implies somewhat less excess supply at mid-year than had been anticipated. Second, higher world oil prices mean that total CPI inflation over the next few quarters will be higher than was projected earlier, although this should not have a significant impact on core inflation. Third, there are signs of some slowing in the U.S. economy.

Higher-than-expected world oil prices mean that total CPI inflation is likely to remain above 2 per cent through the rest of this year, before falling slightly below core inflation in the second half of 2005. Core inflation is projected to remain just above 1.5 per cent for the rest of 2004, before gradually moving back up to the 2 per cent target by the end of 2005.

Economic growth in Canada should average about 3 1/2 per cent in the second half of 2004 and in the first half of 2005, before easing to 3 per cent in the second half. This would imply average annual growth of about 2 3/4 per cent in 2004 and 3 1/2 per cent in 2005.

This profile suggests that the Canadian economy will reach its production capacity by mid-2005.

As economies approach their production capacity, monetary stimulus must be removed to avoid a buildup of inflation pressures. In Canada, the timing and magnitude of interest rate increases will depend on the evolving prospects for inflation and for pressures on capacity. Three factors will play an important role in this respect. The first is the assessment of the size of the output gap. The second is the future growth of Canadian imports and exports, which is particularly uncertain because of the ongoing adjustments to global changes and the recent patterns in trade growth. The third is the overall effect on Canadian output of movements in the world prices of oil and non-energy commodities. In addition, there continue to be heightened geopolitical concerns.