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Opening statement by David Dodge
Governor of the Bank of Canada
to the Standing Senate Committee on Banking, Trade and Commerce
6 December 2007

Good morning, Mr. Chairman and committee members.

Let me start by saying how much I have appreciated our semi-annual meetings with this committee over the past seven years. The discussions that Paul and I have had with you have been very valuable for the Bank of Canada. I hope that you have found them equally useful and that these regular appearances will continue long after I have left the Bank.

Today's meeting comes just a couple of hours after we published the latest edition of our *Financial System Review*. But it has been quite some time since we issued our October *Monetary Policy Report*. Nevertheless, I want to begin with the economic outlook as we saw it in October. I will then talk about developments since that time and our current assessment of the risks to the outlook.

The Bank's outlook from October is summarized in [Tables 1 to 3](#) of the *Monetary Policy Report*. In October, we saw strong global economic growth continuing in 2008 and 2009, although we foresaw considerably weaker U.S. growth in 2008 than had previously been the case. The global outlook is summarized in Table 1.

In Canada, we were looking for weaker economic growth in the fourth quarter of this year and the first half of 2008, but some strengthening thereafter. As you can see from Table 2, we were expecting continued strong final domestic demand throughout the projection period, but considerably weaker net exports. This outlook reflected weaker U.S. growth and a stronger Canadian dollar, which was assumed to average 98 cents U.S. over the projection period. Inflation was expected to peak in the fourth quarter of this year before returning to the 2 per cent target around the middle of 2008, as you can see from Table 3.

Against this background, we left the target for the overnight rate unchanged at 4 1/2 per cent on 16 October, and judged the risks to our outlook to be roughly balanced with perhaps a slight tilt to the downside.

Now, let me turn to developments since October. The Canadian economy continues to operate above its production capacity. Given the strength of domestic demand and weak productivity growth, there continue to be upside risks to the Bank's inflation projection.

However, other developments since October suggest that the downside risks to the Bank's inflation projection have increased. Difficulties in global financial markets,

related to the valuation of structured products and anticipated losses on U.S. subprime mortgages, have worsened since mid-October. These difficulties are expected to persist for a longer period of time than previously thought. In these circumstances, bank funding costs have increased globally and in Canada, and credit conditions have tightened further. There is an increased risk to the prospects for demand for Canadian exports since the outlook for the U.S. economy – particularly, the U.S. housing sector – has weakened.

All these factors considered, the Bank judges that there has been a shift to the downside in the balance of risks around its October projection for inflation through 2009. In light of this shift, the Bank decided to lower the target for the overnight rate at our fixed announcement date on Tuesday. At our next interest rate decision in January, we will assess all economic and financial developments and the balance of risks, and have a full updated projection for the economy and inflation in the *Monetary Policy Report Update*, to be published on 24 January 2008.

Mr. Chairman, Paul and I will now be happy to answer your questions.

	Share of real global GDP ^a (per cent)	Expected growth (per cent) ^b			
		2006	Projection		
			2007	2008	2009
United States	20	2.9 (3.3)	1.9 (2.1)	2.1 (3.0)	3.0 (3.0)
European Union	19	2.9 (2.8)	2.6 (2.6)	2.0 (2.2)	2.2 (2.1)
Japan	6	2.2 (2.2)	2.0 (2.6)	1.7 (1.9)	1.8 (1.8)
China and Asian NIEs ^c	18	10.0 (9.8)	10.0 (9.3)	9.4 (9.0)	8.0 (8.2)
Others	37	6.3 (6.2)	6.3 (5.9)	5.8 (5.7)	5.1 (5.3)
World	100	5.4 (5.4)	5.2 (5.0)	4.8 (4.8)	4.5 (4.6)

- a. GDP shares are based on the purchasing-power-parity (PPP) valuation of country GDPs for 2006. Source: IMF, WEO Database, April 2007
- b. Numbers in parentheses are projections used for the July 2007 *MPR Update*.
- c. NIEs are newly industrialized economies. These include Hong Kong (Special Administrative Region), South Korea, Taiwan (Province of China), and Singapore.
Source: Bank of Canada

	2006	2007	2008	2009
Consumption	2.3 (2.3)	2.1 (2.1)	2.1 (1.9)	2.0 (1.8)
Housing	0.1 (0.1)	0.2 (0.1)	-0.1 (-0.1)	0 (-0.1)
Government	0.8 (0.8)	0.6 (0.6)	0.7 (0.7)	0.6 (0.6)
Business fixed investment	1.2 (1.2)	0.5 (0.6)	0.5 (0.6)	0.5 (0.4)
<i>Subtotal: Final domestic demand</i>	<i>4.4 (4.4)</i>	<i>3.4 (3.4)</i>	<i>3.2 (3.1)</i>	<i>3.1 (2.7)</i>
Exports	0.3 (0.3)	0.5 (0.6)	0.2 (0.9)	0.4 (0.9)
Imports	-1.6 (-1.6)	-1.2 (-1.4)	-1.2 (-1.5)	-1.0 (-1.2)
<i>Subtotal: Net exports</i>	<i>-1.3 (-1.3)</i>	<i>-0.7 (-0.8)</i>	<i>-1.0 (-0.6)</i>	<i>-0.6 (-0.3)</i>
Inventories	-0.3 (-0.3)	-0.1 (-0.1)	0.1 (0.1)	0 (0)
GDP	2.8 (2.8)	2.6 (2.5)	2.3 (2.6)	2.5 (2.4)

* Figures in parentheses are from the base-case projection in the July *Monetary Policy Report Update*.

Table 3 Summary of the Base-Case Projection*							
	2007				2008		2009
	Q1	Q2	Q3	Q4	H1	H2	
Real GDP (quarterly growth or average quarterly growth at annual rates)**	3.9 (3.7)	3.4 (2.8)	2.5 (2.7)	1.8 (2.6)	2.1 (2.6)	2.5 (2.4)	2.6 (2.5)
Real GDP (year-over-year percentage change)	2.0 (2.0)	2.5 (2.3)	2.8 (2.6)	2.9 (2.9)	2.3 (2.6)	2.2 (2.5)	2.5 (2.4)
Core inflation (year-over-year percentage change)	2.3 (2.3)	2.4 (2.4)	2.2 (2.3)	2.3 (2.2)	2.2 (2.2)	2.0 (2.1)	2.0 (2.0)
Total CPI (year-over-year percentage change)	1.8 (1.8)	2.2 (2.3)	2.2 (2.6)	3.0 (3.0)	2.7 (2.4)	1.9 (2.1)	2.0 (2.0)
Total CPI (excluding the effect of changes in indirect taxes) (year-over-year percentage change)	2.3 (2.3)	2.7 (2.8)	2.3 (2.7)	3.0 (3.0)	2.7 (2.4)	1.9 (2.1)	2.0 (2.0)
WTI *** (level)	58 (58)	65 (65)	75 (71)	81 (71)	78 (72)	76 (73)	74 (73)

* Figures in parentheses are from the July *Monetary Policy Report Update*.

** For half and full years, the number reported is the average of the respective quarter-to-quarter percentage growth at annual rates.

*** Assumption for the price of West Texas Intermediate crude oil (US\$ per barrel), based on an average of futures contracts over the two weeks ending 12 October 2007