Opening Statement—*Monetary Policy Report* Press Conference

9 November 2000

This morning we released our latest *Monetary Policy Report*. In the six months since the May *Report*, our economy has outperformed expectations, spurred by strong domestic and foreign demand for Canadian products. We now expect that growth will average 5 per cent in 2000 and 3 to 4 per cent in 2001.

Despite this stronger-than-anticipated expansion and persistently high energy prices, the trend of inflation has so far been lower than expected. To get a fix on the trend of underlying inflation, the Bank uses a measure of core inflation that excludes fluctuations in volatile food and energy prices and the effect of changes in indirect taxes. This measure remains in the lower half of the Bank's 1 to 3 per cent inflation-control target range. And, despite shortages of skilled labour in certain sectors, increases in unit labour costs have been modest. Overall, these developments suggest that the economy had not yet moved into excess demand by mid-2000, but that the level of activity was close to capacity limits.

We have concluded that our conventional estimate of potential output in the May *Report* was understating the actual amount of capacity in the economy. Accordingly, this estimate has been revised upwards in this *Report*.

Let me now turn to our outlook. Although we see the pace of economic expansion moderating, primarily because of the projected slowing of the U.S. economy, the momentum of total demand for Canadian output is still expected to increase pressures on capacity. Consequently, core inflation is projected to rise to the 2 per cent midpoint of the inflation-control target range in the second half of 2001. If crude oil prices were to stabilize at levels just below US$30 per barrel, the rate of increase in the total CPI, which has been significantly above that of core inflation, should gradually move down to about 2 per cent by the end of 2001.

There are three main risks to this outlook. They relate to demand, supply, and inflation expectations.

On the demand side, the key question is whether the recent slowing of the U.S. economy towards a more sustainable pace will continue, or whether excess demand from the United States will again spill over into Canada's exports, increasing inflation pressures here.

On the supply side, strong growth of business spending on machinery and equipment in Canada, coupled with the recent pickup in productivity gains, could raise our production capacity beyond currently projected levels. But until there is further evidence that productivity growth is on a higher path, the Bank must continue to be cautious about the likely future growth of potential output.

A third area of uncertainty relates to world energy prices. Higher energy prices could feed into the prices of other goods and services and into expectations of future inflation.

Given the strong pace and high levels of economic activity in Canada, as well as the increased energy prices, the challenge for monetary policy will be to ensure a sustainable balance between aggregate demand and supply. Our responsibility is to preserve the low trend of inflation and the benefits that it brings to our economy.

[Malcolm and I are now ready to respond to questions]