According to the Bank of Canada:

- The economy is operating at capacity and should grow roughly in line with its production potential through 2007.
- The Bank revised its projections slightly upward: Real GDP will rise 2.9% in 2005 (2.5% in Q4) and 3.1% in 2006, which is similar to our scenario. Core inflation (CPIX) should rise and reach the 2% target in early 2007.
- Risks to the Bank’s projection remain balanced for 2006 but tilt to the downside as of 2007.
- Interest rates will have to be raised a bit more to keep aggregate supply and demand in balance and inflation on target over the medium term.

Commentary:

As expected, this update contained little new information, and the Bank’s rhetoric remains basically the same. Thus, the Bank hardly changed its growth outlook, with real GDP now projected at 2.9% (against 2.8% initially) for 2005 and 3.1% (against 2.9% initially) for 2006. As for inflation, notwithstanding the fact that total inflation decreased faster than expected, the Bank still believes that total and core inflation will reach the 2% target by early 2007.

After analyzing all the indicators of capacity pressures, the monetary authorities decided that the Canadian economy was operating at its production capacity at the end of 2005. For example, in the last Business Outlook Survey, a greater number of companies cited difficulties meeting demand.

The Bank of Canada is categorical: there will be more rate hikes in the coming months. However, the monetary tightening will end sooner than originally announced. It will be recalled that the Bank stated in December that it was contemplating a further tightening of the money supply over the next four to six quarters. Now it looks like the hikes will end with a 25-basis-point increase in April, preceded by an increase on March 7.
BoC Press Release:

[...] The Canadian and world economies are evolving essentially in line with the Bank’s expectations, and the outlook for growth and inflation in Canada is similar to that in the October MPR. Canada’s economy continues to adjust to global developments and to the associated changes in relative prices. The Bank continues to judge that the Canadian economy is operating at its production capacity and will grow roughly in line with its production potential through 2007. Annual GDP growth is expected to be 3.1 per cent this year and 2.9 per cent in 2007, with strong growth in domestic demand and further gains in exports.

Total CPI inflation, which was 2.3 per cent in the fourth quarter of 2005, will continue to be affected by the prices of crude oil and natural gas. The Bank projects that total inflation will be about 2.5 per cent in the first half of 2006, easing to 2 per cent by the first half of 2007. Core inflation, which was 1.6 per cent in the fourth quarter of 2005, should also return to 2 per cent by the first half of next year.

Risks to the Bank’s projection remain balanced for 2006. Through 2007 and beyond, risks are tilted to the downside, as the unwinding of global imbalances could involve a slowdown in world economic activity.

In line with the Bank’s base-case projection and current assessment of risks, some modest further increase in the policy interest rate would be required to keep aggregate supply and demand in balance and inflation on target over the medium term.