To minimize the negative impact of the loonie’s take-off, we feel that the Bank might reduce its key rates to stimulate domestic demand in order to bring the inflation rate back to the target of 2% in the medium term. The country’s inflation rate fell from 2.2% in September to 1.6% in October. Over the next few months, the slowdown in the pace of growth of inflation will continue. It is more and more likely that the rate will even settle slightly below the 1% mark over the winter of 2004. Nonetheless, it should come back up between now and the end of 2004 or the beginning of 2005, unless the world recovery is aborted or the loonie takes on more value. A weakening of global demand—especially US—is unlikely without a new external shock. On the other hand, a new upsurge of the Canadian dollar is still in the cards. It must be understood that the appreciation of our currency seems inevitable and arises from the weakness of the US dollar, the enviable position of the Canadian economy in the world and the increase in the prices of raw materials. A rapid rise in our currency to above 78 cents US that would be maintained beyond that level for some time would probably bring the Bank of Canada to reduce its key rates.

Ultimately, the Bank of Canada’s thorny decision over the coming winter can be summarized in one question: Why is the Canadian economy—an economy that is very focused on trade with the United States and whose rate of growth is lower than the US economy’s and which is experiencing slowing inflation—subject to key rates almost three times higher than in the United States, its main trading partner? To answer this question is to say that Canadian key rates have no reason to be so high and that the risks associated with a reduction in the rates are almost non-existent.