Excerpts from the BoC Press Release:

[...] Recent economic developments bearing on the prospects for economic activity and inflation in Canada reflect a number of cross-currents. Core and total CPI inflation have fallen below the 2 per cent inflation target and are poised to move lower in the short run. Economic growth in Canada in the third quarter was below expectations, owing principally to a sharp inventory correction. [...] 

As a result of weak growth in Canada in the third quarter and downward revisions to growth rates in the first and second quarters of 2003, the output gap is now larger than the Bank had estimated in the October Monetary Policy Report. Therefore, stronger expansion than previously projected will be required in the fourth quarter of 2003 and through 2004 if the output gap is to be closed by early 2005, consistent with returning inflation to the target by mid-2005.

At this time, the Bank expects Canada’s economic growth in the fourth quarter to rebound strongly from the effects of the August power outage in Ontario and from the inventory correction; the Bank also expects an increase in exports reflecting strong U.S. expansion. However, there is uncertainty about the extent to which the appreciation of the Canadian dollar will offset the effects of stronger world demand for Canadian goods and services, and whether the amount of monetary stimulus currently in the economy will support an increase in business investment and household spending sufficient to close the output gap by early 2005.

Given the information currently available, the Bank has decided to leave policy interest rates unchanged at this time. The Bank will watch closely for evidence that aggregate demand and output are expanding at a rate solidly above the growth of potential. [...] 

Conclusion: In the end, the Bank of Canada opted for a slightly more conservative position by leaving its key rates unchanged. On the other hand, there was no great risk in ordering a reduction this morning: inflationary pressure will be very limited over the next few months due to a considerable negative difference between the economy and its output potential. That said, with the adverse effects of the increase in value of the Canadian dollar that can be expected for the foreign trade sector, a drop in the key rates might have been wise. In addition, the Bank of Canada has set the bar quite high with regard to economic growth over the next few quarters. Even if real GDP rebounds in the fourth quarter of 2003, it is far from given that our economy will be able to generate growth “at a considerably higher level than its potential” (meaning growth of at least 4%) and close the negative gap with its output potential as rapidly as desired. The next meeting of the Bank of Canada is on January 20, 2004. Between now and then, various economic indicators will inform us about the effect of this fall’s strong appreciation of our currency. Our central bank might then take the opportunity to lower its key interest rates in order to soften monetary conditions and, in part, counter the effects of the increase in value of the Canadian dollar. But will the Bank’s conservative attitude win out once more?

Gilles Soucy  
VP and Chief Economist

François Dupuis  
Assistant Chief Economist and Strategist

Benoit P. Durocher  
Economist

Phone: (514) 281-2336  
E-mail: desjardins.economics@desjardins.com