The press release this week that accompanied the Bank of Canada’s decision to reduce its key interest rates already gave some idea of our central bank’s viewpoint on recent economic and financial conditions. In that context, this morning’s publication of its semi-annual report on monetary policy clarifies the opinion of the Bank of Canada on developments in the economy, for inflation and, by ricochet, in the direction of future monetary policy.

**Highlights**

- The Bank of Canada’s forecast for economic growth and inflation remains essentially unchanged since the January publication of the *Monetary Policy Report Update*.
- Developments in international conditions, such as the marked realignment of the Canadian dollar, have led to variations in the demand for certain Canadian products, which requires adjustments in activities within businesses. However, most of these remain to come.
- Despite the rebound in real GDP seen in the fourth quarter of 2003, large amounts of production capacity still remain tapped. It will not be until the third quarter of 2005 that our production should return to the full use of its potential.
- Due to the strong appreciation of the Canadian dollar, the growth of the Canadian economy will rely on domestic demand, which will be stimulated by the loosening of monetary policy and the solid confidence of households and businesses. Furthermore, we should experience a solid advance in business investment and consumer spending. As far as the foreign sector is concerned, net exports should not contribute to the growth of real GDP either this year or next.
  - Therefore, the growth of real GDP will be around 2.75% annualized in the first half of 2004 and quicken to 3.5% in the second half of the year. Growth could attain 4% in the first half of 2005. So 2004 should balance out with an increase of 2.75% in real GDP while growth of 3.75% is expected for next year.
  - In the United States, the broadening of real GDP could reach 5% in 2004 and 4.5% in 2005.
  - With regard to inflation, the Bank of Canada expects the annual variation in the reference index (IPCX), currently at 1.1%, to remain at about 1.5% throughout 2004. Core inflation should return close to the target average of 2% between now and the end of 2005.

**Conclusion**

Bottom line, this report on monetary policy does not really throw much new light on future developments in economic conditions in Canada and, by reflection, in key interest rates. At the most, the Bank of Canada reaffirms that “the risks to the outlook appear balanced.” What this confirms is that reductions in the key interest rates are definitely over—barring, of course, an unexpected turnaround in our economy. On the other hand, in light of the outlook presented in the report, it seems evident that there will be a long period of status quo before a new phase of monetary tightening begins in Canada.

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