



## Inflation rate lower

According to the latest Consumer Price Index (CPI) from Statistics Canada, December's month-over-month change came in at 0.1%, on par with November's 0.2% increase. In December, higher prices for inter-city transportation, fuel oil, vegetables and cigarettes were mostly offset by lower prices for gasoline, personal care items, clothing and furniture.

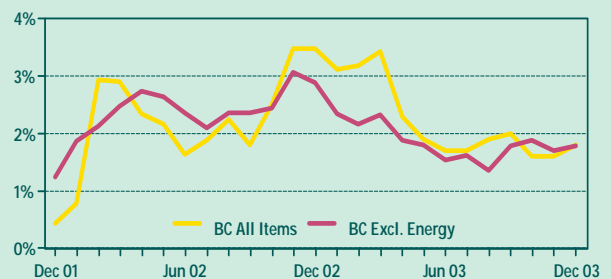
For 2003, consumer price inflation in B.C. averaged 2.1%, down from 2.3% in 2002, although most types of consumer goods and services had a lower rate. For example, food and shelter price inflation averaged 1.8%, while prices for clothing and footwear dropped 1.1% on average.

Generally low rates of consumer price inflation stood in contrast to some items which saw high rates. Energy prices increased 6.6% on average, with fuel oil, piped gas and gasoline prices rising at double-digit rates while electricity prices hardly rose at all. Prices for alcohol and tobacco products jumped 7.3% on average.

Most economists forecast average consumer price inflation in B.C. of less than 2% this year. Energy prices are always a wild card and any supply disruptions will drive up prices and boost total CPI. Underlying inflation forces, however, are expected to remain tame, since the economy as a whole will operate at below capacity. Average wage increases will likely remain below the inflation rate but above last year's increase, since the unemployment rate is moving down.

Consumer price inflation averaged 2.1% in B.C. in 2003

B.C. Consumer Price Index (CPI)  
Year-over-Year Per Cent Change



Source: Statistics Canada.

A similar forecast prevails for Canada as a whole. This year's CPI inflation rate is seen dropping to 1.6% by the forecast consensus, with all analysts expecting lower inflation. Even the Bank of Canada is forecasting a lower inflation rate, at 1.4%, according to its January 2004 monetary policy report. This sets the stage for further interest rate cuts by the Bank.

### Bank of Canada cuts key interest rate

The Bank of Canada has lowered its projection for economic growth over the next 18 months, according to its latest monetary policy report. The Bank concluded that additional monetary stimulus is needed to support economic growth and return inflation to 2% per year over the medium term. Thus, the Bank lowered its key interest rate target by 25 basis points on January 20.

The Bank noted three major changes in the economy over the past three months. Economic growth in the rest of the world, particularly the U.S., has been above expectations. The U.S. dollar has continued its sharp depreciation against major world currencies, including the Canadian dollar. Growth in Canada's real production in 2003 was lower, and the amount of economic slack at the end of the year was larger, than previously estimated.

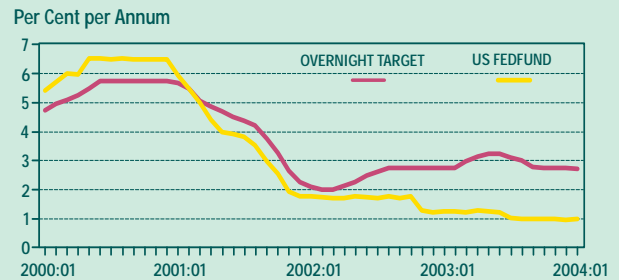
Higher rates of economic growth in the U.S. and the rest of the world have a generally positive impact on economic growth in Canada, by increasing exports of Canadian goods and services. However, the U.S. has clearly cut its propensity to import since the current political administration took power. Thus, the usual boost to Canada's economic growth will be lower than in previous international growth cycles.

The sharply lower U.S. dollar has raised the U.S.-Canada exchange rate dramatically. The higher Canadian dollar will reduce export revenues and boost spending on imports, thereby lowering Canada's net exports (trade surplus). While currency exchange rates forecasts are not very reliable, the Bank expects the lower U.S. dollar to dampen Canada's net exports in 2004. This means the Canadian economy will be relying less on export trade and more on domestic demand.

Accordingly, the Bank cut its projection for Canada's real GDP growth in 2004 from 3.25% to 2.75%. That is, the growth projection shifted from above to below long-term potential, implying that the negative output gap would widen and be more persistent, unless demand increases. In response, the Bank dropped its key short-term policy interest rate, with the aim of stimulating further growth in domestic demand by lowering the cost of borrowing and increasing growth in the Canadian money supply. The Bank thus signalled its intention to cut interest rates further in the near term if existing economic trends persist.

### Canada's monetary policy begins to realign with U.S. monetary policy

#### Key Monetary Policy Rates, Canada and U.S. Monthly Average



Source: Bank of Canada.