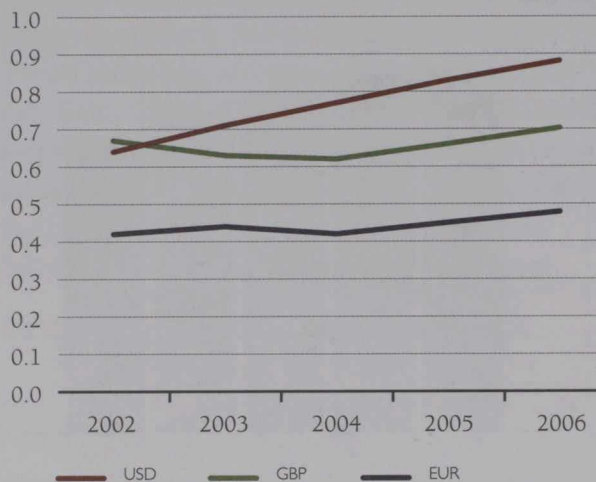


**FIGURE 3-6**  
Canadian Dollar Against the US\$, the Euro and the UK Pound



Source: Bank of Canada

### The dollar

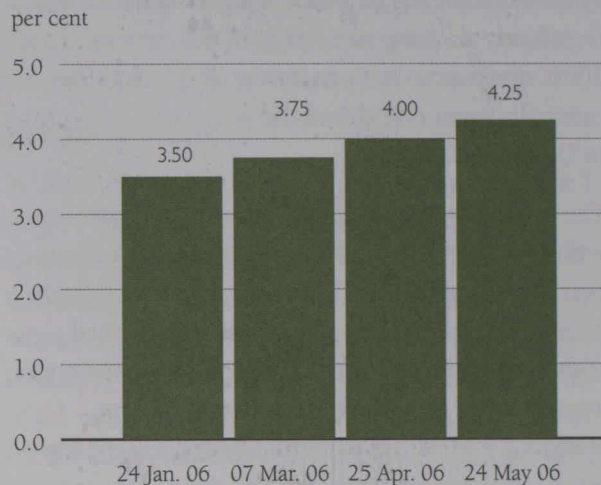
As displayed in Figure 3-6, the appreciation of the Canadian dollar against the main currencies (the US dollar, the euro and the UK pound) continued in 2006. For example, the Canadian dollar appreciated against the US dollar a further 6.8 per cent while the appreciation rates against the euro and the pound were 6.0 per cent and 5.6 per cent, respectively.

The appreciation of the dollar reflected partly a rise in the commodity prices. Despite currency appreciation, Canadian exports of goods increased slightly in 2006 (1.2 per cent). We will show later in the Report that the appreciating dollar has had a greater impact on some categories of goods exports than on others.

### Interest rates

The gradual rise in short-term interest rates observed in 2005 continued in the first half of 2006. As shown in Figure 3-7, the Bank of Canada raised its key policy interest rate by 25 basis points on four occasions through 2006 bringing it to 4.25 per cent.

**FIGURE 3-7**  
The Bank of Canada Key Policy Rate



Source: Bank of Canada

The key policy interest rate has not changed from May 24, 2006 to April 26, 2007.<sup>2</sup> Short-term real interest rates are still low by historical standards, which should sustain consumer spending, investment in residential and non-residential structures. All these factors have underpinned Canadian real GDP growth in recent years.

### Prices

For the entire year 2006, consumers paid an average of 2.0 per cent more than they did in 2005 for the goods and services included in the Consumer Price Index (CPI) basket. The single largest contributor to this increase was homeowner's replacement cost (7.3 per cent)<sup>3</sup>, which can be accounted for by the ongoing demand for new houses, fuelled by rising employment and buoyant economy in the western provinces. Other contributors to the increase in the CPI were electricity (5.7 per cent) reflecting price increases in Alberta and Ontario, gasoline (5.5 per cent), and purchasing and leasing vehicles (1.5 per cent). On the other hand, other factors had a moderating effect on this increase such as

2 The key policy rate is the overnight rate at which major financial institutions borrow and lend one-day funds among themselves; the Bank of Canada sets a target level for that rate. Changes in the target for the overnight rate influence other interest rates, such as those for consumer loans and mortgages. They can also affect the exchange rate.

3 The replacement cost is the cost of replacing worn-out structural components of housing, but it is estimated from the price of new homes (excluding land).