BANK OF CANADA
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Monetary Policy Report Summary

October 2011

This text is a commentary of the Governing Council of the Bank of Canada. It presents the Bank's outlook based on data received up to 21 October 2011.

Highlights

- The global economy has slowed markedly since July.
- The outlook for the Canadian economy has weakened since July, with the significantly less favourable external environment affecting Canada through financial, confidence and trade channels.
- The Canadian economy is projected to expand by 2.1 per cent in 2011, 1.9 per cent in 2012 and 2.9 per cent in 2013.
- The Canadian economy is expected to return to full capacity by the end of 2013. Total CPI inflation is expected to trough around 1 per cent by the middle of 2012 before rising with core inflation to the 2 per cent target by the end of 2013.
- On 7 September and 25 October, the Bank maintained the target for the overnight rate at 1 per cent.

The global economy has slowed markedly as several downside risks to the projection outlined in July have been realized. Financial market volatility has increased and there has been a generalized retrenchment from risk-taking across global markets. The combination of ongoing deleveraging by banks and households, increased fiscal austerity, and declining business and consumer confidence is expected to restrain growth across the advanced economies. The Bank now expects that the euro area—where these dynamics are most acute—will experience a brief recession. The Bank's base-case scenario assumes that the euro-area crisis will be contained, although this assumption is clearly subject to downside risks. In the United States, diminished household confidence, tighter financial conditions and increased fiscal drag are expected to result in weak real GDP growth through the first half of 2012, before growth strengthens gradually thereafter. In Japan, reconstruction activity is projected to boost growth over 2012–13, although Japan's economy will be constrained by reduced global activity and the sharp appreciation of the yen. Growth in China and other emerging-market economies is projected to moderate to a more sustainable pace in response to weaker external demand and the lagged effects of past policy tightening. These developments, combined with recent declines in commodity prices, are expected to dampen global inflationary pressures.

The outlook for the Canadian economy has weakened since July, with the significantly less favourable external environment affecting Canada through financial, confidence and trade channels. Although Canadian growth rebounded in the third quarter with the unwinding of temporary factors, underlying economic momentum has slowed and is expected to remain modest through the middle of next year. Domestic demand is expected to remain the principal driver of growth over the projection horizon, though at a more subdued pace than previously anticipated. Household expenditures are now projected to grow relatively modestly as lower commodity prices and heightened volatility in financial markets weigh on the incomes, wealth and confidence of Canadian households. Business fixed investment is still expected to grow solidly in response to very stimulative financial conditions and heightened competitive pressures, although it will be dampened by the weaker and more uncertain global economic environment. Net exports are expected to remain a source of weakness, owing to sluggish foreign demand and ongoing competitiveness challenges, including the persistent strength of the Canadian dollar.

Overall, the Bank expects that growth in Canada will be slow through mid-2012 before picking up as the global economic environment improves, uncertainty dissipates and confidence increases. The Bank projects that the economy will expand by 2.1 per cent in 2011, 1.9 per cent in 2012 and 2.9 per cent in 2013.

Projection for global economic growth

	Share of real global GDP[a] (per cent)	Projected growth (per cent)[b]			
		2010	2011	2012	2013
United States	20	3.0 (2.9)	1.7 (2.4)	1.7 (3.2)	3.3 (3.3)
Euro area	15	1.7 (1.7)	1.5 (2.0)	0.2 (1.6)	1.5 (1.9)
Japan	6	4.0 (4.0)	-0.6 (-0.6)	2.0 (2.9)	2.5 (3.0)
China	13	10.4 (10.3)	9.1 (9.3)	8.2 (8.6)	8.2 (8.1)
Rest of the world	46	5.7 (5.5)	4.3 (4.2)	3.3 (3.8)	3.4 (3.6)
World	**100**	**5.1 (5.0)**	**3.8 (3.9)**	**3.1 (4.0)**	**3.7 (3.9)**

a. GDP shares are based on IMF estimates of the purchasing-power-parity (PPP) valuation of country GDPs for 2010. Source: IMF, WEO, September 2011

b. Numbers in parentheses are projections used for the July 2011 *Monetary Policy Report*.

Source: Bank of Canada

Summary of the base-case projection for Canada[a]

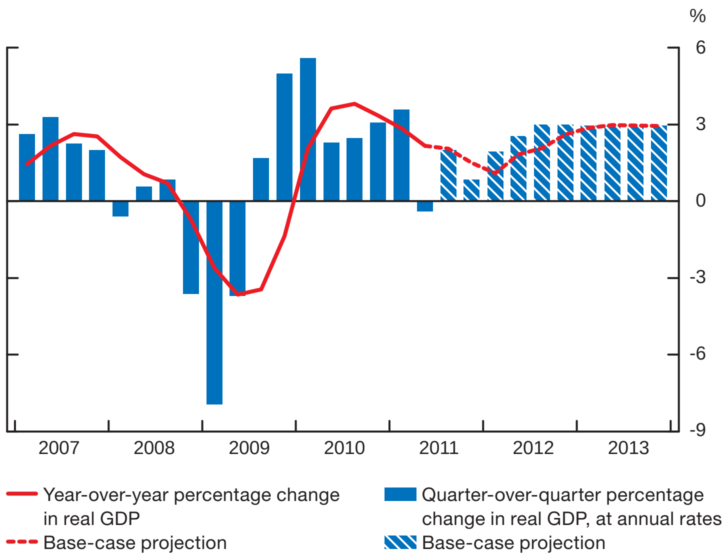
	2010	2011				2012				2013			
	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Real GDP (quarter-over-quarter percentage change at annual rates)	3.1 (3.1)	3.6 (3.9)	-0.4 (1.5)	2.0 (2.8)	0.8 (2.9)	1.9 (2.9)	2.5 (2.6)	3.0 (2.5)	3.0 (2.1)	3.0 (2.1)	3.0 (2.1)	3.0 (2.1)	3.0 (2.1)
Real GDP (year-over-year percentage change)	3.3 (3.3)	2.9 (2.9)	2.2 (2.7)	2.1 (2.8)	1.5 (2.8)	1.1 (2.5)	1.8 (2.8)	2.1 (2.7)	2.6 (2.5)	2.9 (2.3)	3.0 (2.1)	3.0 (2.1)	2.9 (2.1)
Core inflation (year-over-year percentage change)	1.6 (1.6)	1.3 (1.3)	1.6 (1.7)	1.9 (1.9)	2.0 (2.0)	1.8 (2.1)	1.7 (2.0)	1.7 (2.0)	1.6 (2.0)	1.8 (2.0)	1.9 (2.0)	1.9 (2.0)	2.0 (2.0)
Total CPI (year-over-year percentage change)	2.3 (2.3)	2.6 (2.6)	3.4 (3.4)	3.0 (2.8)	2.7 (2.6)	1.9 (2.3)	1.0 (1.9)	1.2 (2.0)	1.5 (2.0)	1.8 (2.0)	1.9 (2.0)	1.9 (2.0)	2.0 (2.0)
Total CPI excluding the effect of the HST and changes in other indirect taxes (year-over-year percentage change)	1.9 (1.9)	2.1 (2.1)	2.9 (2.9)	3.0 (2.8)	2.6 (2.5)	1.9 (2.3)	1.0 (1.9)	1.2 (2.0)	1.5 (2.0)	1.8 (2.0)	1.9 (2.0)	1.9 (2.0)	2.0 (2.0)
WTI[b] (level)	85 (85)	94 (94)	103 (103)	90 (97)	85 (98)	87 (100)	87 (101)	87 (102)	88 (102)	88 (103)	88 (103)	88 (103)	88 (103)

a. Figures in parentheses are from the base-case projection in the July 2011 *Monetary Policy Report*.

b. Assumptions for the price of West Texas Intermediate crude oil (US$ per barrel), based on an average of futures contracts over the two weeks ending 21 October 2011

The weaker economic outlook implies greater and more persistent economic slack than previously anticipated, with the Canadian economy now expected to return to full capacity by the end of 2013. As a result, core inflation is expected to be slightly softer than previously expected, declining through 2012 before returning to 2 per cent by the end of 2013. The projection for total CPI inflation has also been revised down, reflecting the recent reversal of earlier sharp increases in world energy prices as well as modestly weaker core inflation. Total CPI inflation is expected to trough around 1 per cent by the middle of 2012 before rising with core inflation to the 2 per cent target by the end of 2013, as excess supply in the economy is slowly absorbed.

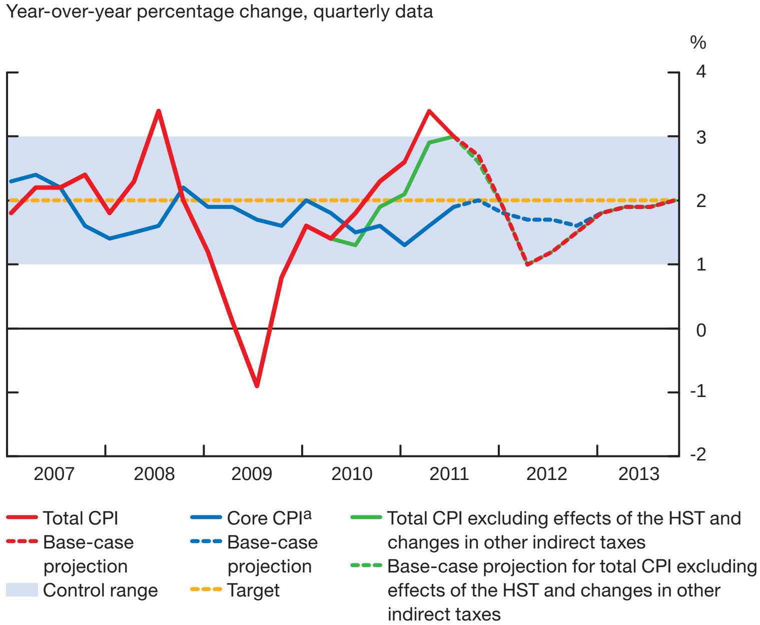
Real GDP growth is expected to pick up through 2012, resulting in a gradual absorption of excess supply



Sources: Statistics Canada and Bank of Canada projections

Total CPI inflation in Canada is projected to fall temporarily near 1 per cent in mid-2012, reflecting the recent decline in world oil prices

Year-over-year percentage change, quarterly data



a. CPI excluding eight of the most volatile components and the effect of changes in indirect taxes on the remaining components

Sources: Statistics Canada and Bank of Canada calculations and projections

Several significant upside and downside risks are present in the inflation outlook for Canada.

The three main upside risks to inflation in Canada relate to the possibility of stronger-than-expected inflationary pressures in the global economy, stronger momentum in Canadian household spending, and the possibility of a faster-than-expected rebound in business and consumer confidence, due to more decisive policy action in the major advanced economies.

The three main downside risks to inflation in Canada relate to sovereign debt and banking concerns in Europe, the increased probability of a recession in the U.S. economy, and the possibility that growth in household spending could be weaker than projected.

Overall, the Bank judges that these risks are roughly balanced over the projection horizon.

Reflecting all of these factors, on 25 October, the Bank maintained the target for the overnight rate at 1 per cent. With the target interest rate near historic lows and the financial system functioning well, there is considerable monetary policy stimulus in Canada. The Bank will continue to monitor carefully economic and financial developments in the Canadian and global economies, together with the evolution of risks, and set monetary policy consistent with achieving the 2 per cent inflation target over the medium term.

The Bank of Canada's *Monetary Policy Report* is published quarterly in January, April, July and October.

Print copies of the *Report* and the *Summary* may be obtained by contacting Publications Distribution, Communications Department, Bank of Canada, 234 Wellington St., Ottawa, Ontario, Canada K1A 0G9

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ISSN 1924-1089 (Print) ISSN 1925-3168 (Online)