



Monetary Policy Report Summary

April 2012

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 13 April 2012.

The profile for global economic growth has improved since January. Europe is expected to emerge slowly from recession in the second half of 2012, although the risks around this outlook remain high. The profile for U.S. growth is slightly stronger, reflecting the balance of somewhat improved labour markets, financial conditions and confidence on the one hand, and emerging fiscal consolidation and ongoing household deleveraging on the other. Economic activity in emerging-market economies is expected to moderate to a still-robust pace over the projection horizon, supported by an easing of macroeconomic policies. Improved global economic prospects, supply disruptions and geopolitical risks have kept commodity prices elevated. In particular, the international price of oil has risen further and is now considerably higher than that received by Canadian producers. If sustained, these oil price developments could dampen the improvement in economic momentum.

Overall, economic momentum in Canada is slightly firmer than the Bank had expected in January. The external headwinds facing Canada have abated somewhat, with the U.S. recovery more resilient and financial conditions more supportive than previously anticipated. As a result, business and household confidence are improving faster than forecast in January. The Bank projects that private domestic demand will account for almost all of Canada's economic growth over the projection horizon. Household spending is expected to remain high relative to GDP as households add to their debt burden, which remains the biggest domestic risk. Business investment is projected to remain robust, reflecting solid balance sheets, very favourable credit conditions, continuing strong terms of trade and heightened competitive pressures. The contribution of government spending to growth is expected to be quite modest over the projection horizon, in line with recent federal and provincial budgets. The recovery in net exports is likely to remain weak in light of modest external demand and ongoing competitiveness challenges, including the persistent strength of the Canadian dollar.

Highlights

- The profile for global economic growth has improved since January.
- Economic momentum in Canada is slightly firmer than the Bank had expected.
- The Bank projects the Canadian economy will grow by 2.4 per cent in 2012 and 2013 before moderating to 2.2 per cent in 2014. The economy is now expected to return to full capacity in the first half of 2013.
- Total and core inflation are expected to be around 2 per cent over the balance of the projection horizon.
- On 8 March and 17 April, the Bank maintained the target for the overnight rate at 1 per cent.

The Bank projects that the economy will grow by 2.4 per cent in both 2012 and 2013 before moderating to 2.2 per cent in 2014. The degree of economic slack has been somewhat smaller than the Bank had anticipated in January, and the economy is now expected to return to full capacity in the first half of 2013.

As a result of this reduced slack and higher gasoline prices, the profile for inflation is expected to be somewhat firmer than anticipated in January. After moderating this quarter, total CPI inflation is expected, along with core inflation, to be around 2 per cent over the balance of the projection horizon as the economy reaches its production potential, the growth of labour compensation remains moderate and inflation expectations stay well anchored.

Despite recent improvements to the outlook for the global and Canadian economies, risks remain elevated.

The three main upside risks to inflation in Canada relate to the possibility of higher-than-expected oil prices, stronger-than-expected growth in the U.S. economy and stronger momentum in Canadian household spending.

The two main downside risks to inflation in Canada relate to a reintensification of sovereign debt and banking concerns in Europe, and the possibility that growth in Canadian household spending could be weaker than projected.

Projection for global economic growth

	Share of real global GDP ^a (per cent)	Projected growth (per cent) ^b			
		2011	2012	2013	2014
United States	20	1.7 (1.8)	2.3 (2.0)	2.5 (2.2)	3.6
Euro area	15	1.5 (1.5)	-0.6 (-1.0)	0.8 (0.9)	1.4
Japan	6	-0.7 (-0.8)	1.9 (1.9)	1.6 (1.7)	1.6
China	14	9.2 (9.1)	8.1 (8.2)	8.0 (8.0)	8.0
Rest of the world	46	4.3 (4.2)	3.4 (3.1)	3.5 (3.2)	3.7
World	100	3.8 (3.7)	3.2 (2.9)	3.4 (3.3)	3.8

a. GDP shares are based on International Monetary Fund (IMF) estimates of the purchasing-power-parity (PPP) valuation of country GDPs for 2010. Source: IMF, *World Economic Outlook*, September 2011

b. Numbers in parentheses are projections used for the January 2012 *Monetary Policy Report*.

Source: Bank of Canada

Summary of the base-case projection for Canada^a

	2011	2012				2013				2014			
	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Real GDP (quarter-over-quarter percentage change at annual rates)	1.8 (2.0)	2.5 (1.8)	2.5 (1.8)	2.4 (2.1)	2.5 (2.6)	2.5 (3.1)	2.2 (3.1)	2.3 (3.0)	2.2 (2.8)	2.2	2.2	2.2	2.2
Real GDP (year-over-year percentage change)	2.2 (2.1)	2.0 (1.7)	2.7 (2.3)	2.3 (1.9)	2.5 (2.1)	2.5 (2.4)	2.4 (2.7)	2.4 (2.9)	2.3 (3.0)	2.2	2.2	2.2	2.2
Core inflation (year-over-year percentage change)	2.1 (2.2)	2.1 (2.1)	1.9 (2.0)	1.8 (1.9)	1.8 (1.7)	1.8 (1.9)	2.1 (1.9)	2.1 (2.0)	2.1 (2.0)	2.1	2.0	2.0	2.0
Total CPI (year-over-year percentage change)	2.6 (2.8)	2.4 (2.2)	2.0 (1.5)	2.2 (1.7)	2.2 (1.7)	2.1 (1.8)	1.9 (1.9)	1.9 (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)	2.5 (2.7)	2.3 (2.1)	1.9 (1.4)	2.1 (1.6)	2.1 (1.6)	2.1 (1.8)	2.0 (1.9)	2.0 (2.0)	2.0 (2.0)	2.0	2.0	2.0	2.0
WTI ^b (level)	94 (94)	103 (101)	103 (102)	104 (102)	105 (101)	105 (100)	105 (99)	104 (98)	103 (98)	102	101	99	99
Brent ^b (level)	109 (109)	118 (112)	122 (111)	121 (110)	119 (109)	117 (107)	115 (106)	113 (105)	112 (103)	110	108	106	104

a. Figures in parentheses are from the base-case projection in the January 2012 *Monetary Policy Report*.

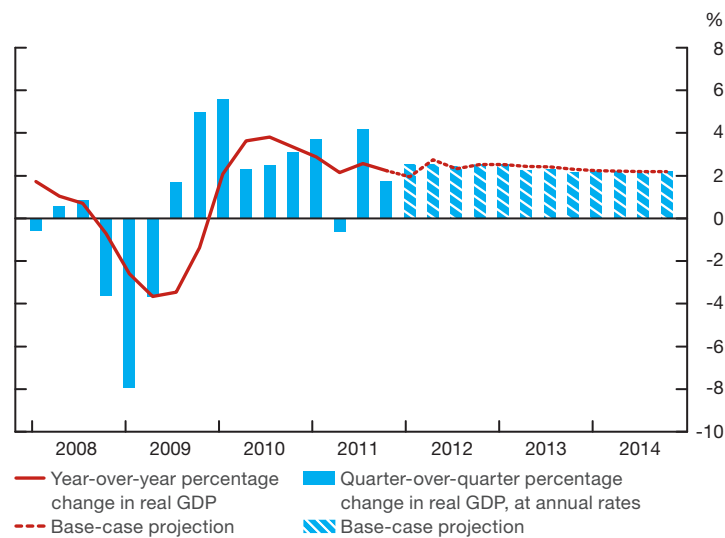
b. Assumptions for the prices of West Texas Intermediate and Brent crude oil (US\$ per barrel), based on an average of futures contracts over the two weeks ending 13 April 2012

Overall, the Bank judges that the risks to the inflation outlook in Canada are roughly balanced over the projection period.

Reflecting all of these factors, on 17 April, the Bank maintained the target for the overnight rate at 1 per cent. In light of the reduced slack in the economy and firmer underlying inflation, some modest withdrawal of

the present considerable monetary policy stimulus may become appropriate, consistent with achieving the 2 per cent inflation target over the medium term. The timing and degree of any such withdrawal will be weighed carefully against domestic and global economic developments.

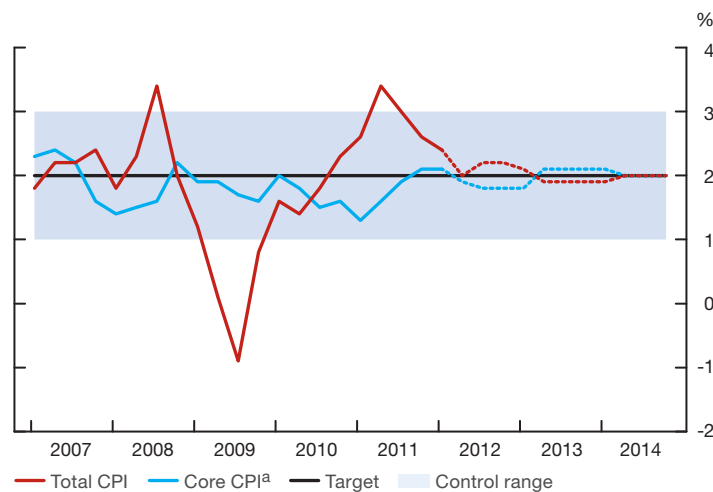
Real GDP is expected to grow at a moderate pace



Sources: Statistics Canada and Bank of Canada calculations and projections

Total and core CPI inflation in Canada are projected to remain close to 2 per cent over the projection horizon

Year-over-year percentage change, quarterly data



Note: Dotted lines indicate projections.

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

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