

Monetary Policy Report Summary

January 2014

This text is a commentary of the Governing Council of the Bank of Canada.

Highlights

- Inflation has moved further below the 2 per cent target and its path is now expected to be lower than previously projected. Inflation is expected to return to the 2 per cent target in about two years.
- Global economic growth is expected to strengthen over the next two years, led by stronger momentum in the United States.
- In Canada, growth improved in the second half of 2013, although there have been few signs of the anticipated rebalancing towards exports and business investment.
- The Bank projects that the Canadian economy grew by 1.8 per cent in 2013, and will grow by 2.5 per cent in both 2014 and 2015, gradually returning to full production capacity over the next two years.

Inflation in Canada has moved further below the 2 per cent target, owing largely to significant excess supply in the economy and heightened competition in the retail sector. The path for inflation is now expected to be lower than previously anticipated for most of the projection period. The Bank expects inflation to return to the 2 per cent target in about two years, as the effects of retail competition dissipate and excess capacity is absorbed.

Global growth is expected to strengthen over the next two years, rising from 2.9 per cent in 2013 to 3.4 per cent in 2014 and 3.7 per cent in 2015. The United States will lead this acceleration, aided by diminishing fiscal drag, accommodative monetary policy and stronger household balance sheets. The improving U.S. outlook is affecting global bond, equity, and currency markets. Growth in other regions is evolving largely as projected in October. Global trade growth plunged after 2011, but is poised to recover as global demand strengthens.

In Canada, growth improved in the second half of 2013. However, there have been few signs of the anticipated rebalancing towards exports and business investment. Stronger U.S. demand, as well as the recent depreciation of the Canadian dollar, should help to boost exports and, in turn, business confidence and investment. Meanwhile, recent data have been consistent with the Bank's expectation of a soft landing in the housing market and a stabilization of household indebtedness relative to income.

Real GDP growth is projected to pick up from 1.8 per cent in 2013 to 2.5 per cent in both 2014 and 2015. This implies that the economy will return gradually to capacity over the next two years.

The outlook for inflation is subject to several risks emanating from both the external environment and the domestic economy. The most important risks are stronger U.S. investment, underperformance in Canadian exports, and imbalances in the household sector. Overall, the Bank judges that the risks to the projection for inflation are roughly balanced.

Although the fundamental drivers of growth and future inflation appear to be strengthening, inflation is expected to remain well below target for some time, and therefore the downside risks

to inflation have grown in importance. At the same time, risks associated with elevated household imbalances have not materially changed. Weighing these considerations, the Bank judges that the balance of risks remains within the zone articulated in October, and therefore has decided to maintain the target for the overnight rate at 1 per cent. The timing and direction of the next change to the policy rate will depend on how new information influences this balance of risks.

Projection for global economic growth

	Share of real global GDP ^a (per cent)	Projected growth ^b (per cent)			
		2012	2013	2014	2015
United States	20	2.8 (2.8)	1.9 (1.5)	3.0 (2.5)	3.2 (3.3)
Euro area	14	-0.6 (-0.6)	-0.4 (-0.4)	0.9 (1.0)	1.4 (1.3)
Japan	5	1.4 (2.0)	1.7 (1.8)	1.8 (1.5)	1.1 (1.0)
China	15	7.7 (7.7)	7.7 (7.7)	7.2 (7.4)	7.1 (7.2)
Rest of the world	47	3.2 (3.2)	2.9 (2.8)	3.2 (3.4)	3.8 (3.7)
World	100	3.1 (3.1)	2.9 (2.8)	3.4 (3.4)	3.7 (3.6)

a. GDP shares are based on International Monetary Fund (IMF) estimates of the purchasing-power-parity (PPP) valuation of country GDPs for 2012. The individual shares may not add up to 100 owing to rounding.

Source: IMF, *World Economic Outlook*, October 2013

b. Numbers in parentheses are projections used for the October 2013 *Monetary Policy Report*.

Source: Bank of Canada

Summary of the projection for Canada^a

	2012	2013				2014				2015			
	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Real GDP (quarter-over-quarter percentage change at annual rates)	0.9 (0.9)	2.3 (2.2)	1.6 (1.7)	2.7 (1.8)	2.5 (2.3)	2.5 (2.3)	2.5 (2.3)	2.5 (2.4)	2.6 (2.6)	2.5 (2.7)	2.5 (2.7)	2.3 (2.6)	2.2 (2.5)
Real GDP (year-over-year percentage change)	1.0 (1.0)	1.4 (1.4)	1.4 (1.4)	1.9 (1.7)	2.3 (2.0)	2.3 (2.0)	2.5 (2.2)	2.5 (2.4)	2.5 (2.4)	2.5 (2.5)	2.5 (2.6)	2.5 (2.7)	2.4 (2.7)
Core inflation (year-over-year percentage change)	1.2 (1.2)	1.3 (1.3)	1.2 (1.2)	1.3 (1.3)	1.2 (1.4)	1.0 (1.3)	1.2 (1.5)	1.3 (1.6)	1.5 (1.7)	1.6 (1.8)	1.7 (1.9)	1.8 (1.9)	1.9 (2.0)
Total CPI (year-over-year percentage change)	1.0 (1.0)	0.9 (0.9)	0.7 (0.7)	1.1 (1.1)	0.9 (1.3)	0.9 (1.2)	1.2 (1.4)	1.4 (1.6)	1.5 (1.7)	1.7 (1.8)	1.9 (1.9)	1.9 (1.9)	2.0 (2.0)
Total CPI excluding the effect of the HST and changes in other indirect taxes (year-over-year percentage change)	0.8 (0.8)	0.9 (0.9)	0.8 (0.8)	1.2 (1.2)	1.0 (1.4)	1.0 (1.3)	1.2 (1.4)	1.4 (1.6)	1.5 (1.7)	1.7 (1.8)	1.9 (1.9)	1.9 (1.9)	2.0 (2.0)
WTI ^b (level)	88 (88)	94 (94)	94 (94)	106 (106)	98 (102)	93 (101)	93 (99)	91 (97)	89 (95)	87 (93)	86 (91)	84 (90)	83 (88)
Brent ^b (level)	110 (110)	113 (113)	103 (103)	110 (110)	109 (110)	107 (108)	106 (107)	105 (105)	103 (104)	102 (102)	101 (100)	100 (99)	99 (98)

a. Numbers in parentheses are from the projection in the October 2013 *Monetary Policy Report*.

b. Assumptions for the price of West Texas Intermediate and Brent crude oil (US\$ per barrel) are based on an average of futures contracts over the two weeks ending 17 January 2014.