

Monetary Policy Report Summary

April 2015

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

Highlights

- On 15 April, the Bank maintained the target for the overnight rate at 3/4 per cent.
 - Total CPI inflation in Canada is at 1 per cent, while core inflation has remained close to 2 per cent in recent months.
 - Global economic growth is expected to strengthen and average 3 1/2 per cent per year over 2015-17.
 - The front-loaded impact of the oil price shock in Canada has contributed to a very weak first quarter, which has led to a widening of the output gap and additional downward pressure on projected inflation.
 - Real GDP growth in Canada is projected to rebound in the second quarter and subsequently strengthen to average about 2 1/2 per cent on a quarterly basis until the middle of 2016. The Bank expects real GDP growth of 1.9 per cent in 2015, 2.5 per cent in 2016, and 2.0 per cent in 2017.
 - As the economy reaches and remains at full capacity around the end of 2016, both total and core inflation are projected to be close to 2 per cent on a sustained basis.
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Total CPI inflation is at 1 per cent, reflecting the drop in consumer energy prices. Core inflation has remained close to 2 per cent in recent months, as the temporary effects of sector-specific factors and pass-through of the lower Canadian dollar have offset the disinflationary forces from slack in the economy.

The Bank expects global growth to strengthen and average 3 1/2 per cent per year over 2015-17, in line with the projection in the January *Monetary Policy Report* (MPR). This is in part because many central banks have eased monetary policies in recent months to counter persistent slack and low inflation, as well as the effect of lower commodity prices in some cases. At the same time, economies continue to adjust to lower oil prices, which have fluctuated at or below levels assumed in the January MPR. Strong growth in the United States is expected to resume in the second quarter of 2015 after a weak first quarter.

The Canadian economy is estimated to have stalled in the first quarter of 2015. The Bank's assessment is that the impact of the oil price shock on growth will be more front-loaded – but not larger – than predicted in January. The ultimate size of this impact will need to be monitored closely. Underneath the effects of the oil price shock, the natural sequence of stronger

non-energy exports, increasing investment, and improving labour markets is progressing. This sequence will be bolstered by the considerable easing in financial conditions that has occurred and by improving U.S. demand. As the impact of the oil shock on growth dissipates, this natural sequence is expected to re-emerge as the dominant trend around mid-year. Real GDP growth is projected to rebound in the second quarter and subsequently strengthen to average about 2 1/2 per cent on a quarterly basis until the middle of 2016. The Bank expects real GDP growth of 1.9 per cent in 2015, 2.5 per cent in 2016, and 2.0 per cent in 2017.

The very weak first quarter has led to a widening of Canada's output gap and additional downward pressure on projected inflation. However, the anticipated recovery in growth means that the output gap will be back in line with its previous trajectory later this year. Consequently, the effects on core inflation of the lower dollar and the output gap will continue to offset each other. As the economy reaches and remains at full capacity around the end of 2016, both total and core inflation are projected to be close to 2 per cent on a sustained basis.

The outlook for inflation is subject to several risks emanating from both the external environment and the domestic economy. The most important are the risks of a greater impact on the Canadian economy of the decline in oil prices; a disorderly unwinding of imbalances in the Canadian household sector; and stronger-than-expected private demand in the United States.

Risks to the outlook for inflation are now roughly balanced and risks to financial stability appear to be evolving as expected. The Bank judges that the current degree of monetary policy stimulus remains appropriate and therefore is maintaining the target for the overnight rate at 3/4 per cent.

Projection for global economic growth

	Share of real global GDP ^a (per cent)	Projected growth ^b (per cent)			
		2014	2015	2016	2017
United States	16	2.4 (2.4)	2.7 (3.2)	3.0 (2.8)	2.6
Euro area	12	0.9 (0.8)	1.2 (0.9)	1.3 (1.2)	1.3
Japan	5	-0.1 (0.1)	0.4 (0.6)	1.5 (1.6)	1.3
China	16	7.4 (7.4)	6.9 (7.2)	6.8 (7.0)	6.5
Rest of the world	51	3.3 (2.9)	3.1 (3.1)	3.5 (3.4)	3.7
World	100	3.3 (3.1)	3.3 (3.4)	3.6 (3.5)	3.6

a. GDP shares are based on International Monetary Fund (IMF) estimates of the purchasing-power-parity (PPP) valuation of country GDPs for 2013 from the IMF's October 2014 *World Economic Outlook*.

b. Numbers in parentheses are projections used for the Bank's January 2015 *Monetary Policy Report*.

Source: Bank of Canada

Summary of the projection for Canada^a

	2014	2015				2016				2017			
	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Real GDP (quarter-over-quarter percentage change at annual rates)	2.4 (2.5)	0.0 (1.5)	1.8 (1.5)	2.8 (2.0)	2.5 (2.5)	2.5 (2.6)	2.5 (2.6)	2.3 (2.6)	2.1 (2.3)	2.0	1.9	1.8	1.8
Real GDP (year-over-year percentage change)	2.6 (2.5)	2.4 (2.6)	1.9 (2.1)	1.8 (1.9)	1.8 (1.9)	2.4 (2.1)	2.6 (2.4)	2.5 (2.6)	2.4 (2.5)	2.2	2.1	1.9	1.9
Core inflation (year-over-year percentage change)	2.2 (2.2)	2.1 (2.0)	2.1 (1.9)	2.0 (1.8)	2.1 (1.9)	2.1 (1.9)	2.1 (1.9)	2.0 (1.9)	2.0 (2.0)	2.0	2.0	2.0	2.0
Total CPI (year-over-year percentage change)	2.0 (2.0)	1.0 (0.5)	0.8 (0.3)	0.9 (0.5)	1.4 (1.2)	2.1 (1.9)	2.1 (1.9)	2.0 (1.9)	2.0 (2.0)	2.0	2.0	2.0	2.0

a. Numbers in parentheses are from the projection in the January 2015 *Monetary Policy Report*. Assumptions for the price for crude oil are based on the average of spot prices since early March.

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