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Bank of Canada releases *Monetary Policy Report Update*

OTTAWA—The Bank of Canada today released its January *Monetary Policy Report Update*, which discusses current economic and financial trends in the context of Canada's inflation-control strategy.

In the *Update*, the Bank noted that the outlook for the global economy has deteriorated since the October *Monetary Policy Report*, with the intensifying financial crisis spilling over into real economic activity. Heightened uncertainty is undermining business and household confidence worldwide and further eroding domestic demand. Major advanced economies, including Canada's, are now in recession, and emerging-market economies are increasingly affected. Commodity prices – especially energy prices – have fallen as a result of substantially weaker global demand.

Stabilization of the global financial system is a precondition for economic recovery. To that end, governments and central banks are taking bold and concerted policy actions. There are signs that these extraordinary measures are starting to gain traction, although it will take some time for financial conditions to normalize. In addition, considerable monetary and fiscal policy stimulus is being provided worldwide.

The *Update* notes that Canadian exports are down sharply, and domestic demand is shrinking as a result of declines in real income, household wealth, and confidence. Canada's economy is projected to contract through mid-2009, with real GDP dropping by 1.2 per cent this year on an annual average basis. As policy actions begin to take hold in Canada and globally, and with support from the past depreciation of the Canadian dollar, real GDP is expected to rebound, growing by 3.8 per cent in 2010.

A wider output gap through 2009 and modest decreases in housing prices should cause core CPI inflation to ease, bottoming at 1.1 per cent in the fourth quarter. Total CPI inflation is expected to dip below zero for two quarters in 2009, reflecting year-on-year drops in energy prices. With inflation expectations well-anchored, total and core inflation should return to the 2 per cent target in the first half of 2011 as the economy returns to potential.

Global developments pose significant upside and downside risks to the inflation projection. On the upside, the global economy could be stronger, if global fiscal stimulus turns out to be more expansionary than expected, or if aggressive policy actions taken across major economies restore confidence more quickly than projected. On the downside, the global recession could be deeper and more protracted because financial conditions take longer to normalize. The Bank judges that the risks are roughly balanced.

Against this background, the Bank lowered its policy rate by 50 basis points on Tuesday to 1 per cent, bringing the cumulative monetary policy easing to 350 basis points since December 2007. Guided by Canada's inflation-targeting framework, the Bank will continue to monitor carefully economic and financial developments in judging to what extent further monetary stimulus will be required to achieve the 2 per cent target over the medium term. Low, stable, and predictable inflation is the best contribution monetary policy can make to long-term economic growth and financial stability.