



BANK OF CANADA
BANQUE DU CANADA

The Global & Canadian Economies: The Outlook through 2010

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Outline

Presentation is organized around five issues:

- (1) Global financial market developments
- (2) The Canadian economy today
- (3) Outlook for the Canadian economy
- (4) Implications for monetary policy
- (5) Major risks to the outlook for inflation

Global financial market developments

- ❖ Failures or near-failures of several large financial institutions has led to uncertainty about credit-related losses & the amount of re-capitalization needed.
- ❖ Deleveraging & falling asset prices has resulted in extremely volatile & difficult financial conditions.

[Chart 1](#)

- ❖ Liquidity in financial markets contracted sharply, as financial institutions became increasingly reluctant to lend to each other. [Chart 2](#)

Global financial market developments

- ❖ These problems originated outside our borders, and the primary solutions to correct them must take place there as well.
- ❖ Actions to stabilize financial markets are being directed to:
 - providing liquidity to markets;
 - re-capitalizing financial institutions;
 - restoring the flow of credit.

Global financial market developments

- ❖ Implementation of the G-7 Plan of Action in the U.S., UK & Euro Area represents a pivotal point:
 - support systemically important financial institutions;
 - unfreeze credit and money markets;
 - ensure that deposit insurance and guarantee programs are robust and consistent;
 - restart the secondary markets for mortgages & other securitized assets.
- ❖ The G-20 meeting this past week-end adds force to these initiatives
- ❖ In addition, we had concerted monetary policy action on 8 October by the Bank of Canada & other major central banks.
- ❖ Considerable further monetary policy easing has occurred since then.

Global financial market developments

Recent Bank of Canada actions:

- ❖ Liquidity provided to reinforce target overnight rate
- ❖ Provision of term liquidity:
 - \$30 billion term PRA (repo) outstanding;
 - weekly operations announced until end of year.
- ❖ Broadened eligible counterparties
- ❖ Broadened list of eligible securities for term PRA and loans
- ❖ Reduce target overnight rate

Global financial market developments

Canada: a co-ordinated Action Plan:

- ❖ Bank of Canada:
 - liquidity provided out to 3 months

- ❖ Government of Canada:
 - Canadian Lenders Assurance Facility;
 - 3 months to 3 years
 - acquisition of \$25 billion insured mortgage pools for Canadian lenders via loans to CMHC.

Global financial market developments

Conclusion:

- ❖ The right issues have been identified:
 - re-capitalization;
 - Liquidity;
 - restoring credit flows.
- ❖ The right actions are being taken:
 - globally;
 - Domestically.
- ❖ To gain full traction will take time.

The Canadian economy today

Major shocks facing Canadian economy:

- ❖ Intensification of the global financial crisis.
- ❖ Growing evidence of a mild recession in the global economy.
- ❖ Sharp declines in many commodity prices, especially oil. [Chart 3](#)

The Canadian economy today

Developments in the real economy:

- ❖ Canadian economic growth has slowed abruptly this year. [Chart 4](#)
- ❖ Export volumes have fallen & final demand has decelerated.
- ❖ The economy has moved into slight excess supply in 2008 Q3. [Chart 5](#)

The Canadian economy today

Inflation developments:

- ❖ Core inflation has remained below 2 per cent, reflecting a one-time price level effect.
- ❖ Total inflation peaked at 3.5 per cent in August, but excluding the effects of the GST, it was 4.0 per cent.

[Chart 6](#)

The Canadian economy today

Credit market developments:

- ❖ While under stress, our financial system is sound & functioning.
- ❖ Credit growth has been strong compared to other countries. [Chart 7](#), [Chart 8](#)

The Canadian economy today

Conclusion:

The Canadian economy's starting point going into this difficult period is better than most:

- ❖ Sound financial system.
- ❖ Stronger household, corporate & government balance sheets.
- ❖ A sound macroeconomic policy framework to guide decisions.

Outlook for the Canadian economy

The global outlook:

- ❖ Uncertainty around the outlook is much greater than usual.
- ❖ Key assumptions:
 - G-7 Plan of Action stabilizes financial markets;
 - Price of oil between \$81-\$88US;
 - Canadian dollar trades at 85¢US.
- ❖ The global economy is entering into a mild recession, led by the U.S. [Table 1](#)
- ❖ Negative growth is projected for U.S. GDP through 2009 Q1, after which growth gradually picks up through the rest of the year & accelerates further in 2010.

Outlook for the Canadian economy

The Canadian outlook:

- ❖ The near-term outlook for the Canadian economy is for sluggish growth through the first half of 2009.
- ❖ The economy is then projected to pick up over the rest of 2009 & to accelerate to above potential growth in 2010. [Chart 9](#)
- ❖ The economy returns to full production capacity by early 2011.

Outlook for the Canadian economy

Main drivers:

- ❖ The contribution to growth from final domestic demand declines through 2009, but rebounds in 2010. [Table 2](#)
- ❖ Net exports exert a smaller drag on the economy in 2008-2009, and then contribute positively to growth.
- ❖ This profile is supported by improved credit conditions, lagged effects of monetary policy actions, & stronger global growth. [Chart 10](#)
- ❖ The recent sizable depreciation of the Canadian dollar will also provide important support.

Outlook for the Canadian economy

Inflation outlook:

- ❖ Inflation pressures are expected to ease significantly.
- ❖ Core inflation is expected to remain below 2 per cent until the end of 2010. [Chart 11](#)
- ❖ Total CPI inflation falls below 1 per cent in mid-2009, before returning to the 2 per cent target by the end of 2010. [Chart 11](#)

Implications for monetary policy

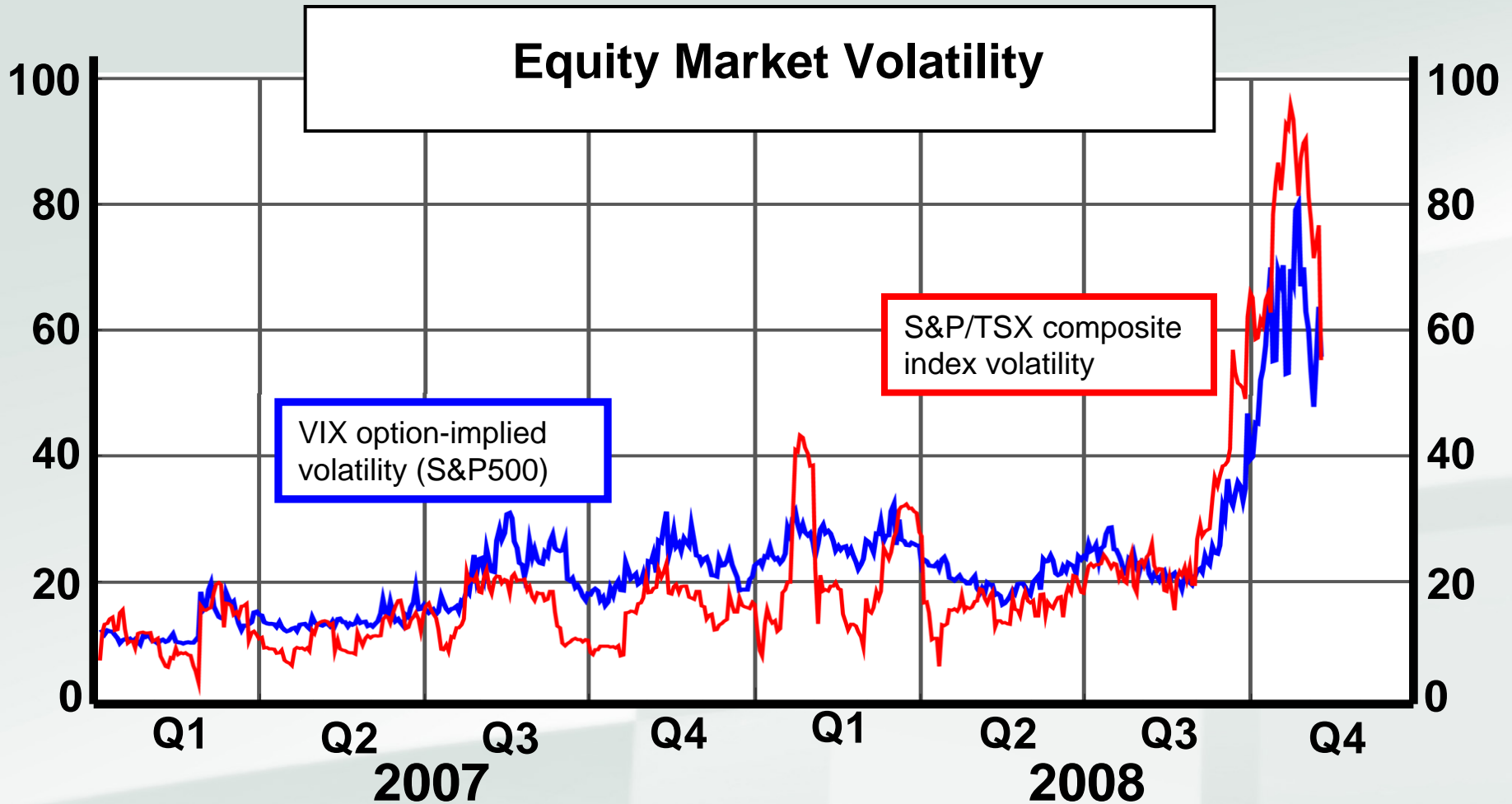
- ❖ The Bank of Canada lowered its policy rate by 50 basis points on 8 October, acting in concert with other major central banks. [Chart 12](#)
- ❖ Together with the 25 basis point reduction on 21 October, this brings the cumulative reduction in the target overnight rate to 225 basis points since last December, lowering it to 2.25 per cent.
- ❖ In line with the new outlook, some further monetary stimulus will likely be required to achieve our 2 per cent inflation target over the medium term.

Major risks to our inflation outlook

- ❖ The Bank judges that the risks are roughly balanced around its revised base case projection.
- ❖ The evolution of the financial crisis, its impact on the economy, and the timing of the effect of various extraordinary measures taken to address it pose significant downside & upside risks.
- ❖ Reminder: uncertainty around the outlook is much greater than usual.

End of presentation

Global financial market developments



* This volatility measure is based on a 10-day historical average.

** The VIX (Chicago Board Option Volatility Index) is a popular measure of implied volatility obtained from option contracts on the S&P 500 Index.

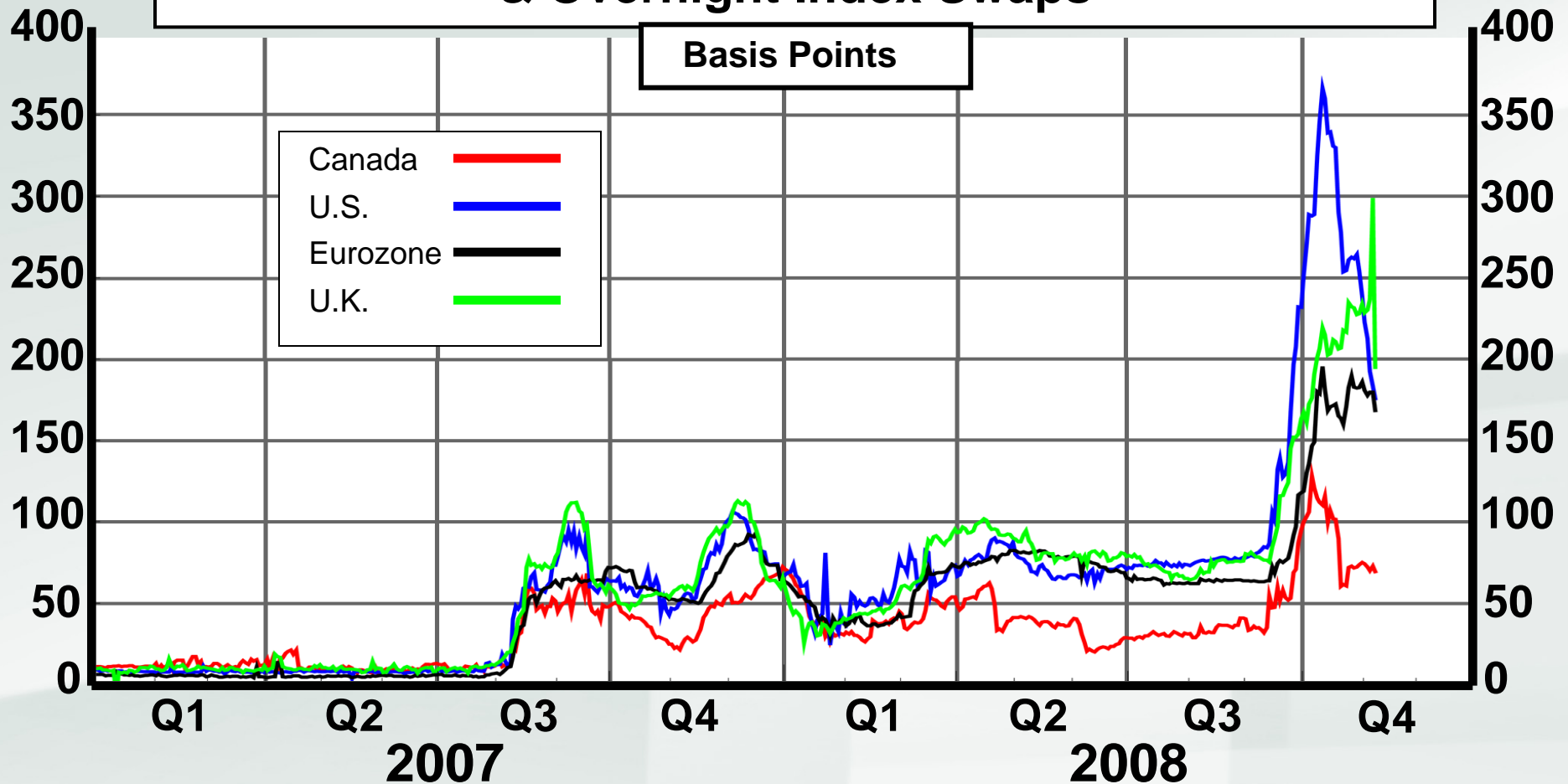
Source: Bloomberg

Chart 1

Global financial market developments



Spreads between 3-month Interbank offered Rates & Overnight Index Swaps *



* The difference between 3-month interbank offered rates & their respective overnight index swaps; for the United States & the United Kingdom, LIBOR for the euro zone, EURIBOR; & for Canada, CDOR.

Source: Bloomberg

Chart 2

The Canadian economy today



Bank of Canada Commodity Price Index

1982-90 = 100

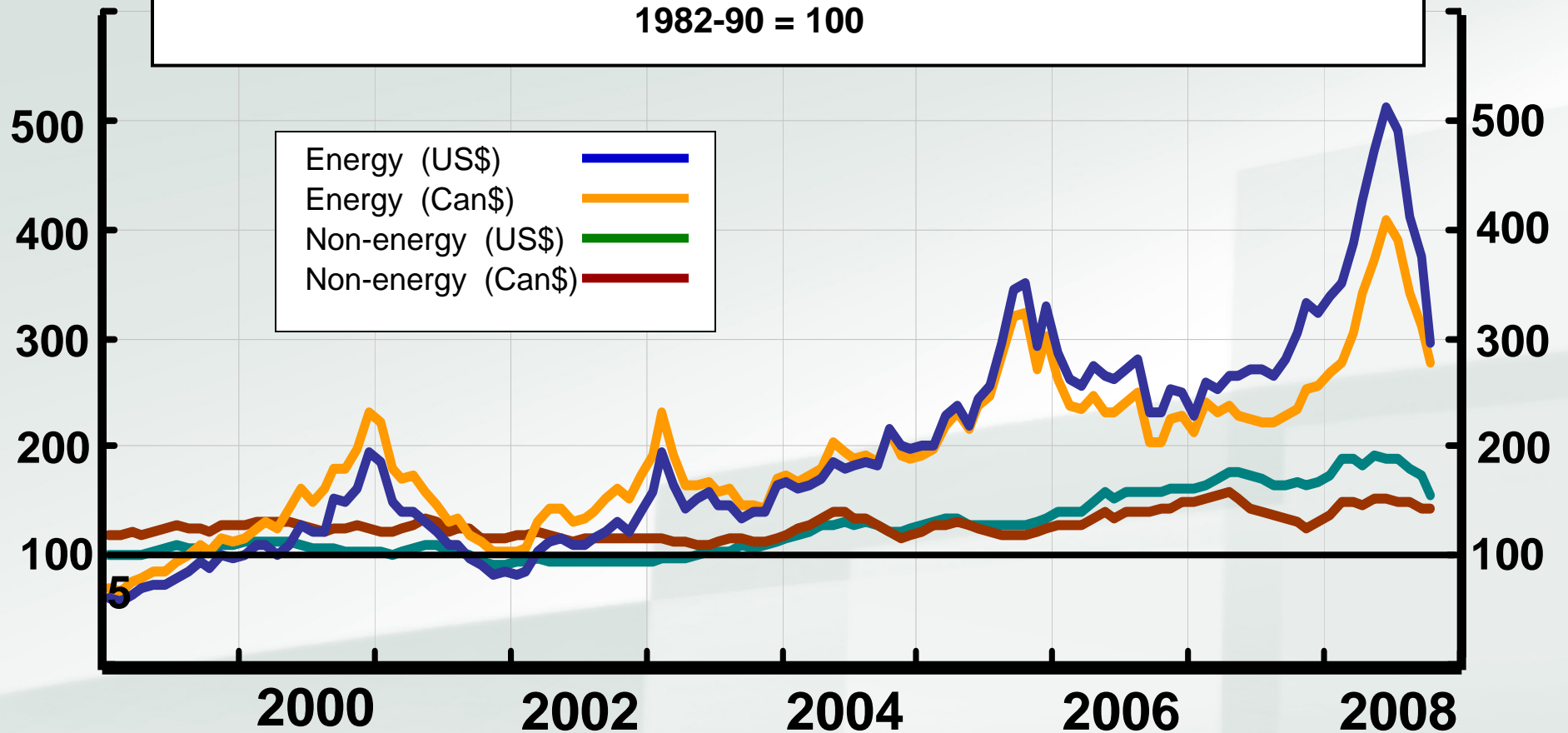


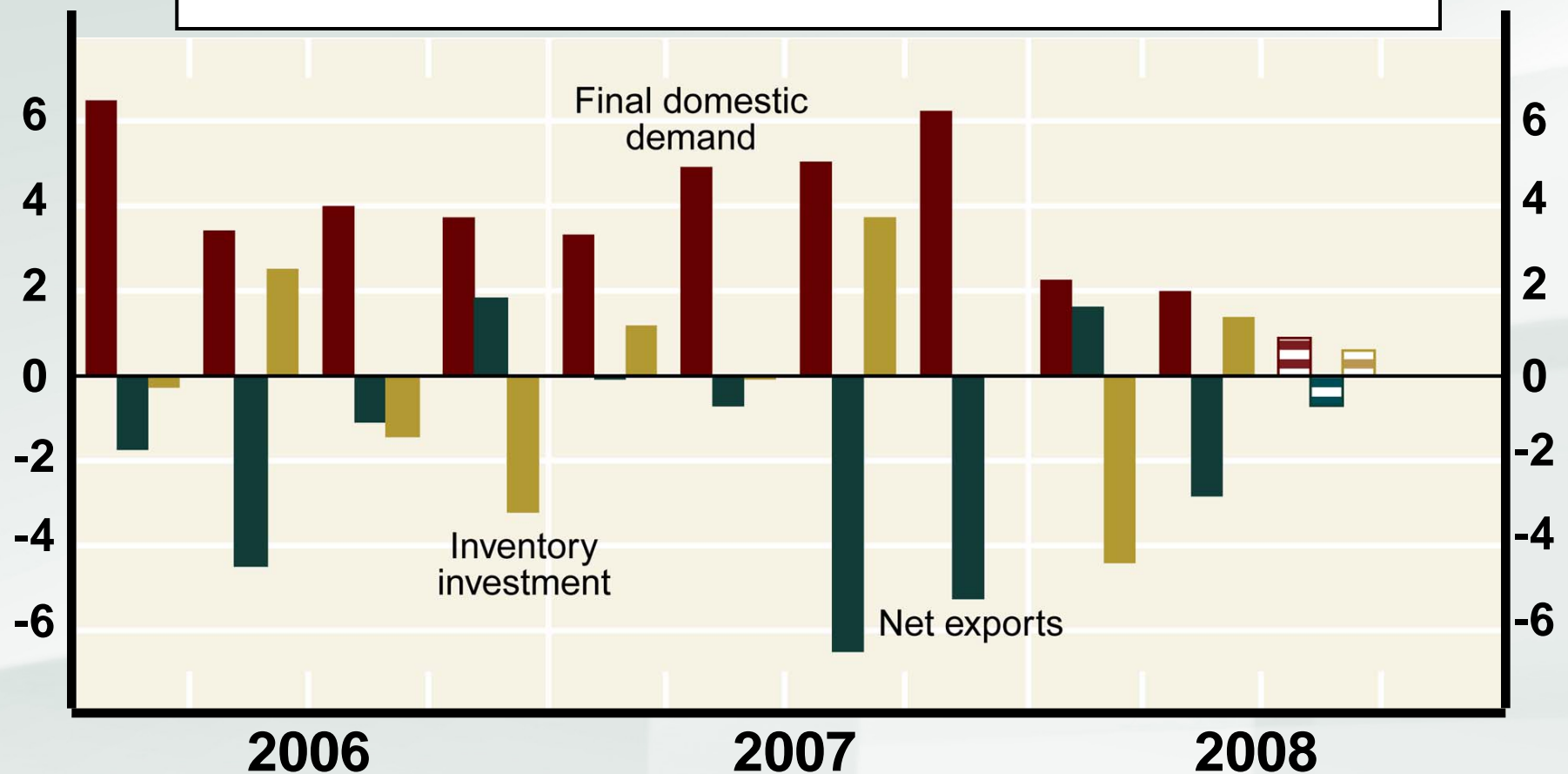
Chart 3

The Canadian economy today



Contribution to Real GDP Growth

Percentage points, quarterly at an annual rate



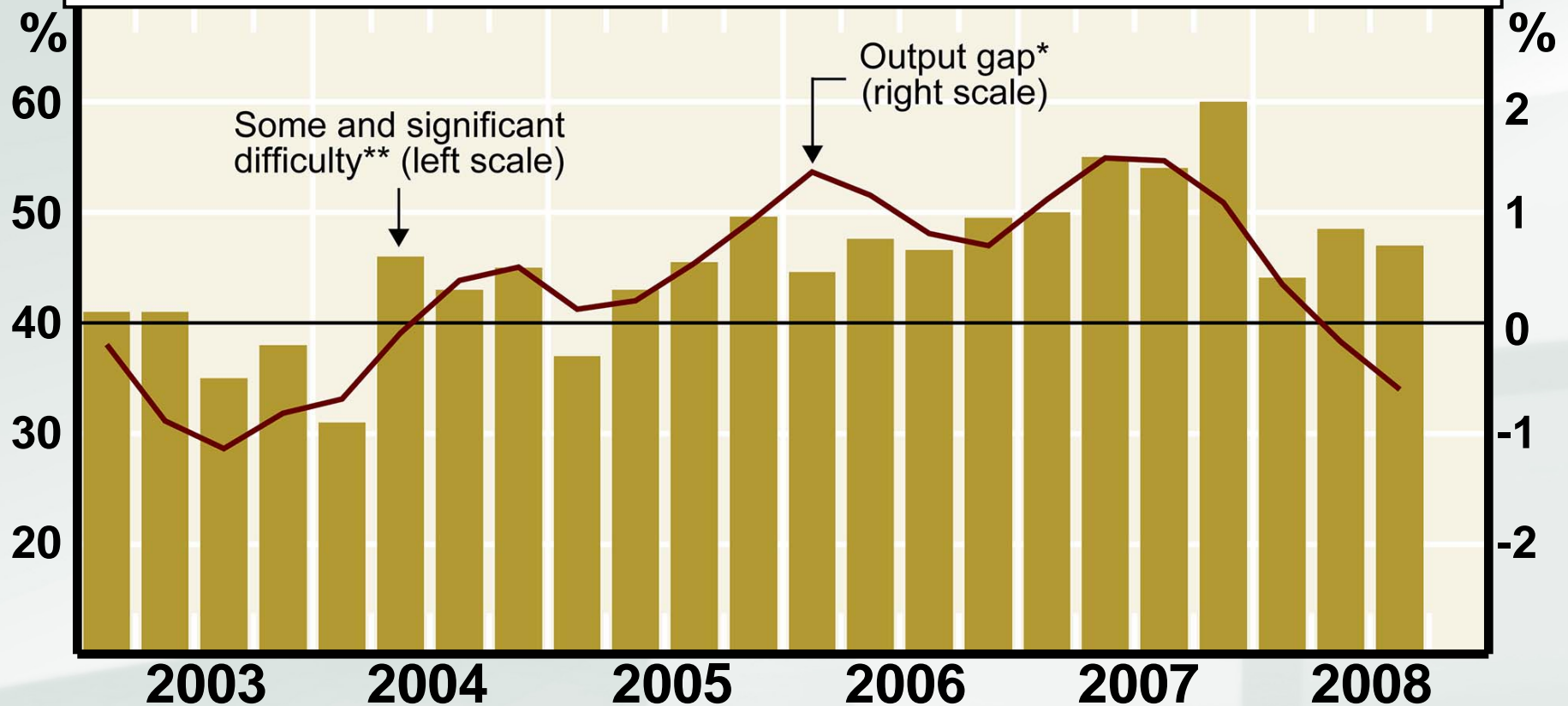
Note: GDP estimates for the 3rd quarter of 2008 are based on the Bank's monitoring of current data

Chart 4

The Canadian economy today



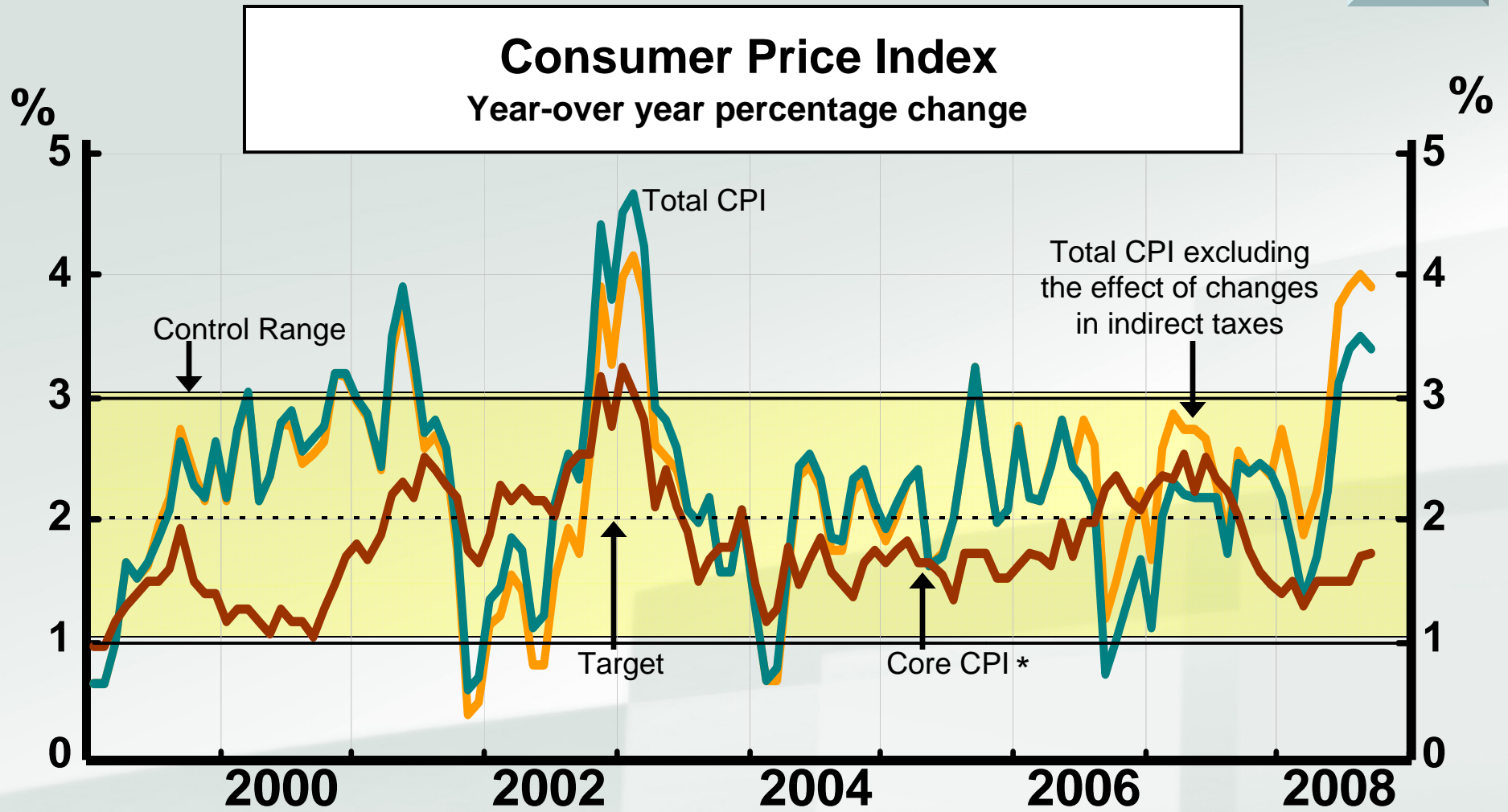
Estimated Output Gap & Response to Business Outlook Survey Question on Capacity Pressures



* Difference between actual output & estimated potential output. The estimate for the 3rd quarter of 2008 is based on a projected rise in output of 0.8 per cent (at annual rates) for the quarter.

** Percentage of firms indicating they would have either some or significant difficulty meeting an unanticipated increase in demand/sales.

The Canadian economy today

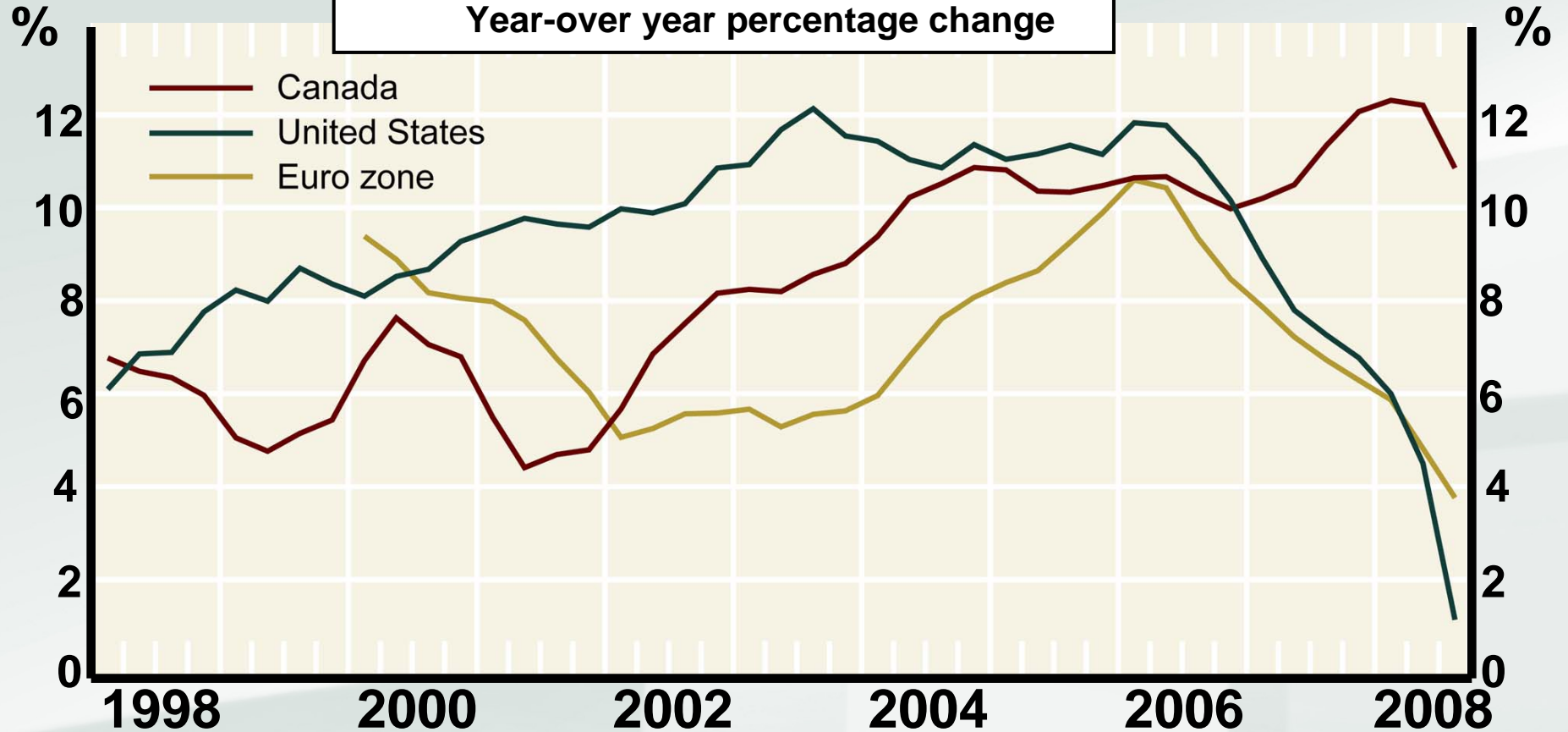


* CPI excluding 8 of the most volatile components & the effect of changes in indirect taxes on the remaining components

The Canadian economy today



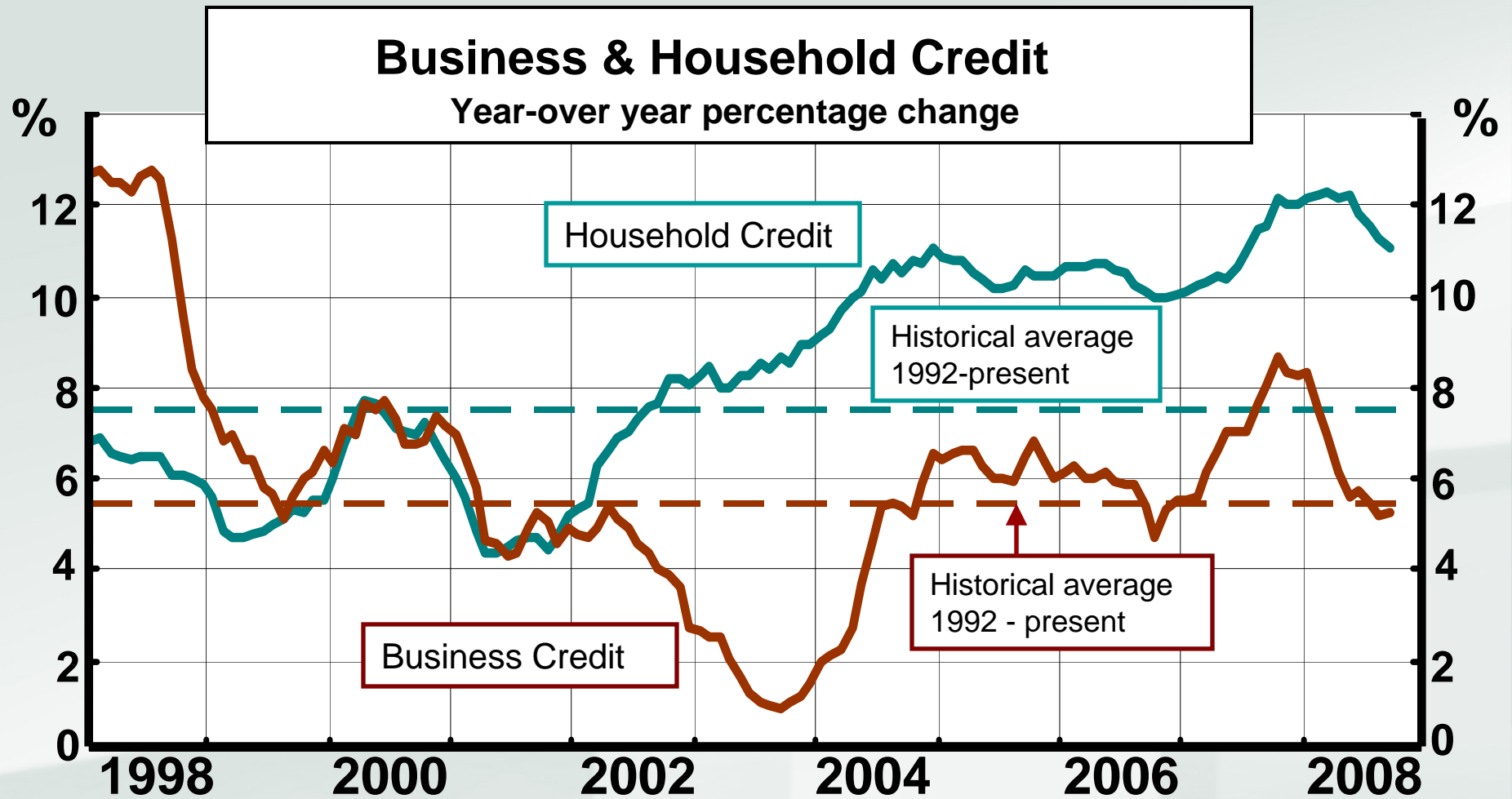
Total Household Credit
Year-over year percentage change



Note: The last data point plotted is the average of July & August 2008.

Sources: Bank of Canada, BIS, U.S. Federal Reserve

The Canadian economy today



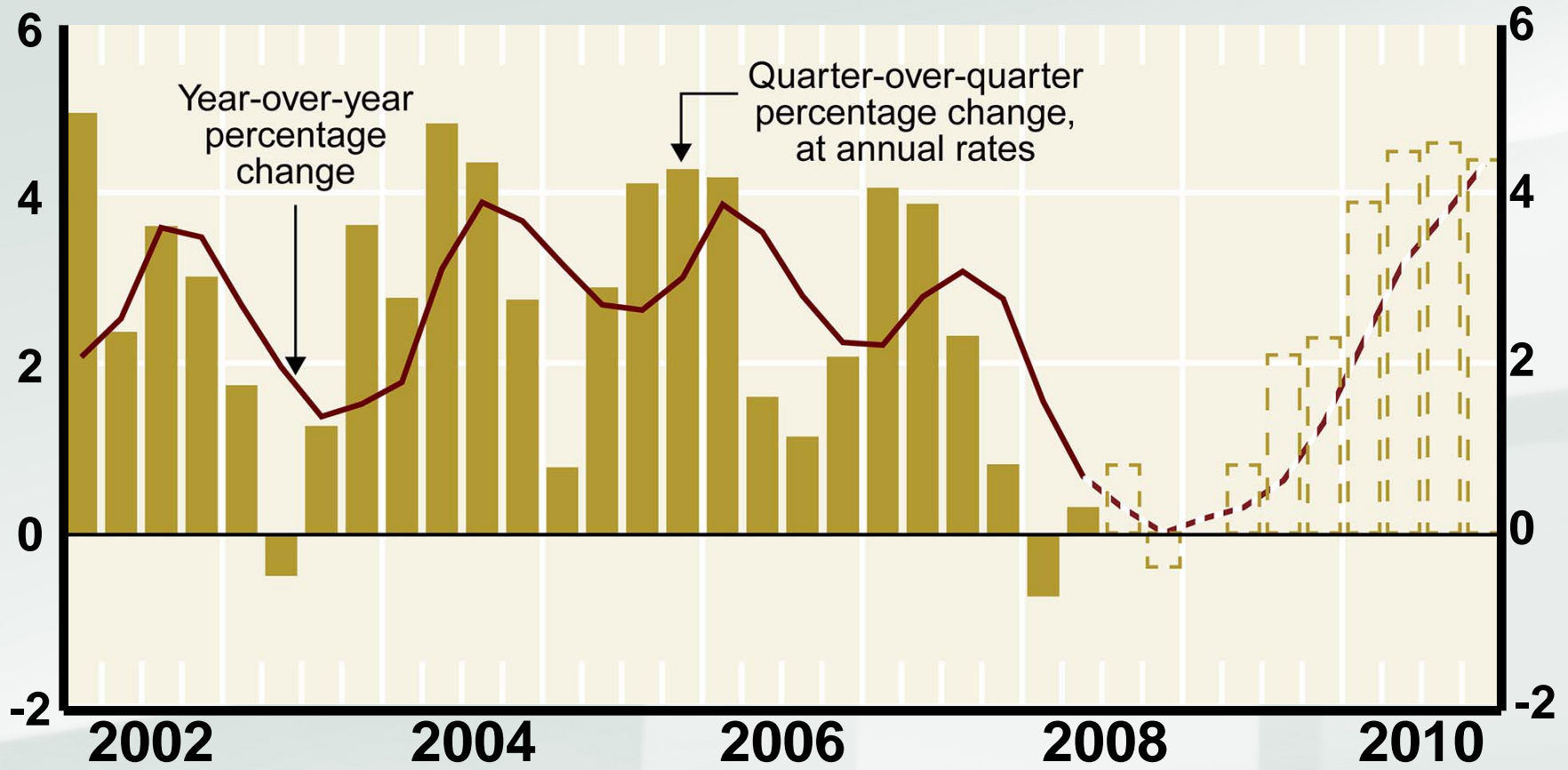
Note: The last data point plotted is September 2008.

Sources: Bank of Canada calculation

Outlook for the Canadian economy



Real Gross Domestic Product for Canada *



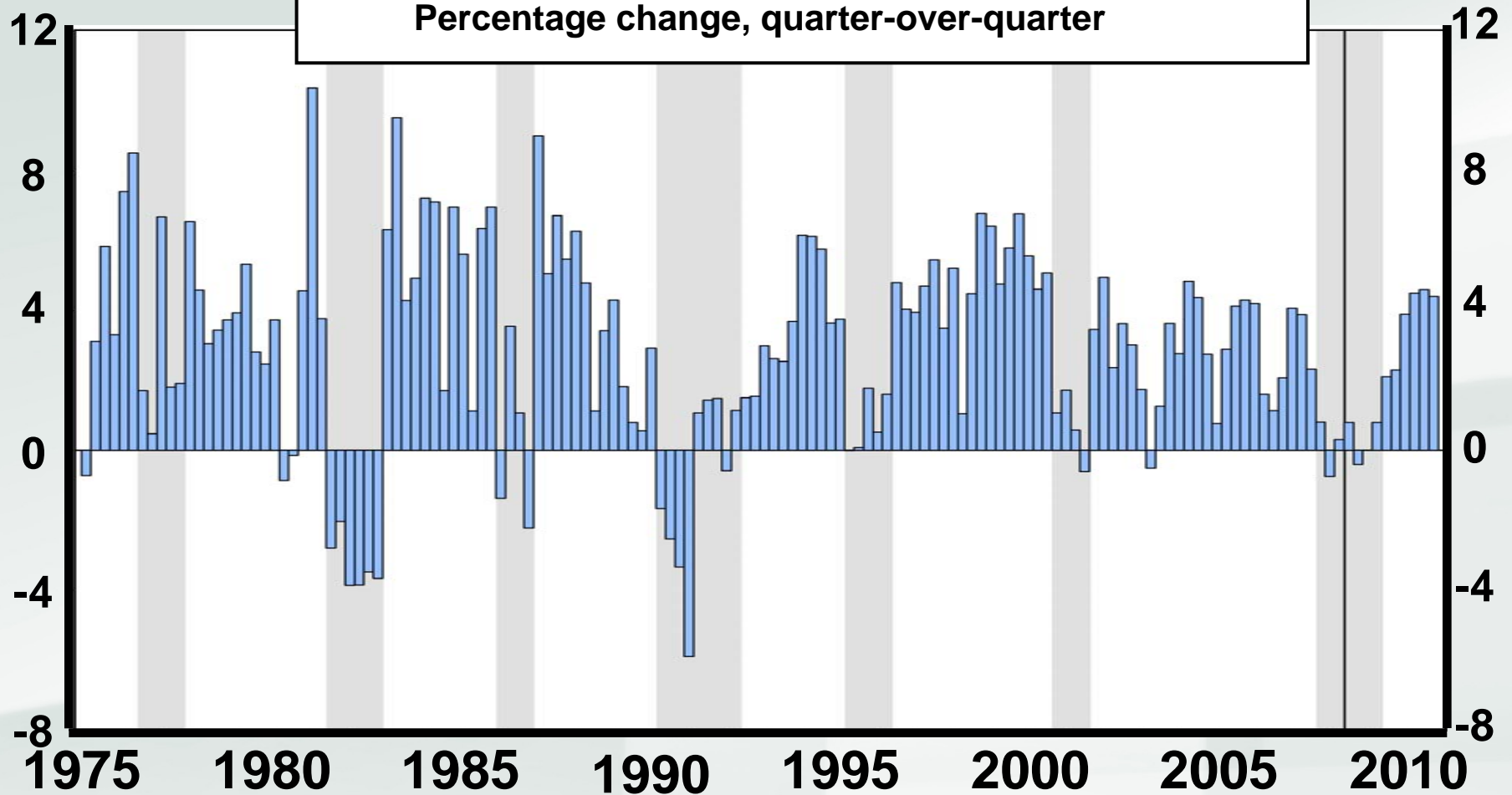
* The broken line & bars indicate the base-case projection

Outlook for the Canadian economy

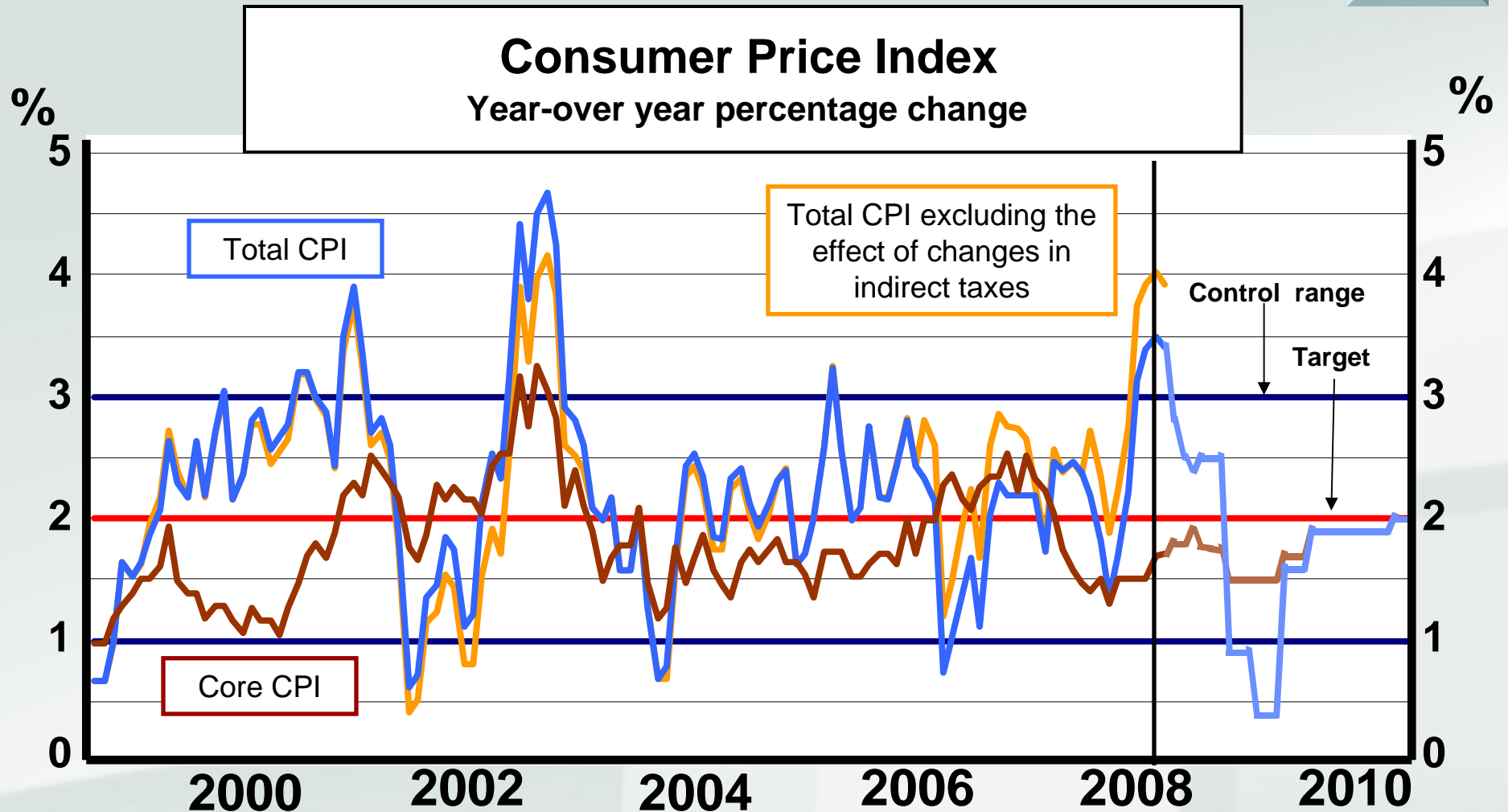


Real GDP Growth Profile

Percentage change, quarter-over-quarter

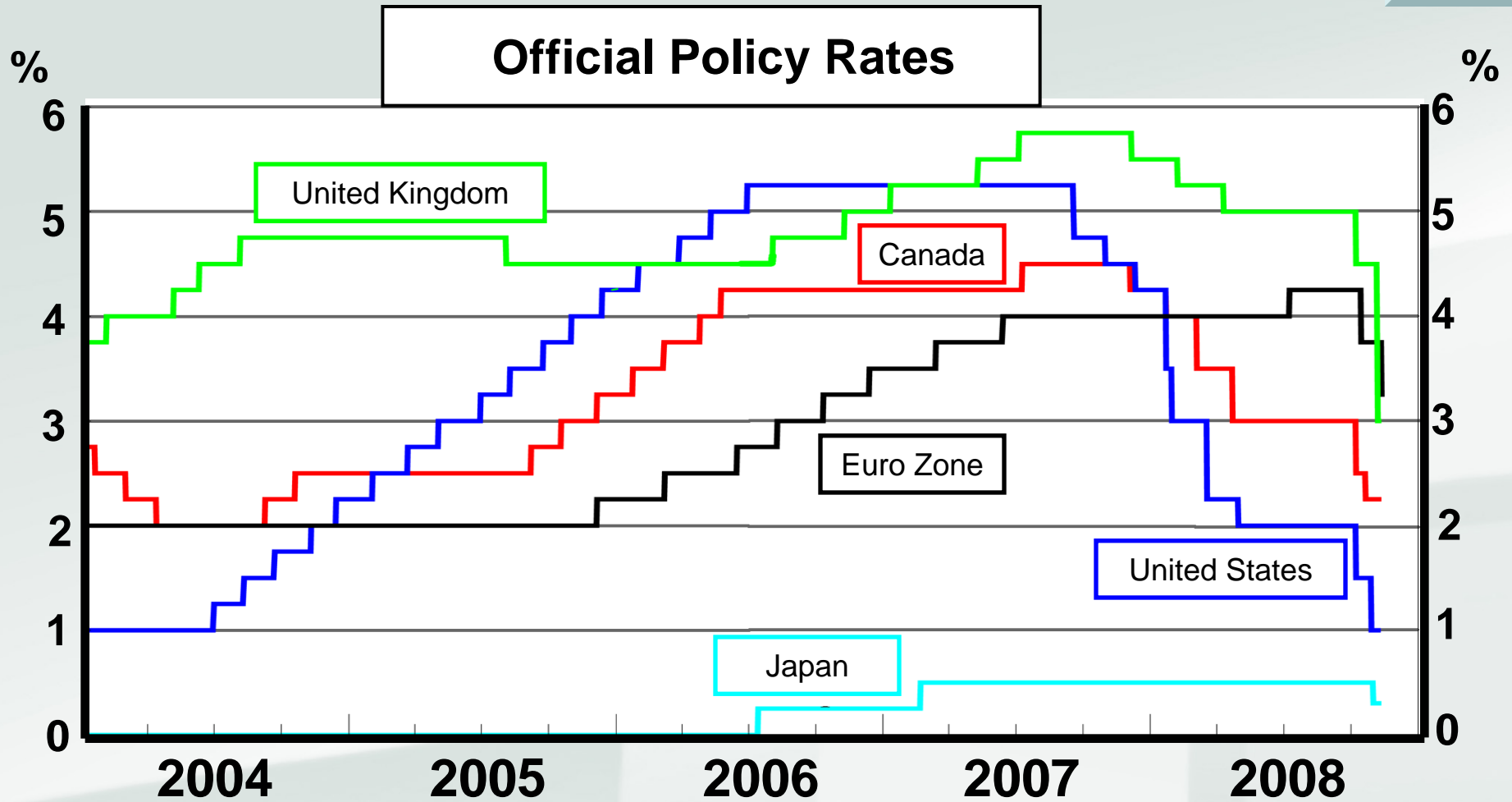


Outlook for the Canadian economy



Solid lines represent actual Statistics Canada data. Dotted lines represent forecast.

Implications for monetary policy



Source: Bank of Canada, U.S. Federal Reserve, Bank of Japan, Bank of England, & European Central Bank

Outlook for the Canadian economy



Projection for Global Economic Growth

	Share of real global GDP ^a (per cent)	Projected growth (per cent) ^b			
		2007	2008	2009	2010
United States	22	2.0 (2.2)	1.2 (1.6)	-0.1 (1.5)	3.2 (3.3)
European Union	20	2.7 (2.7)	1.0 (1.7)	0.3 (1.5)	3.0 (2.3)
Japan	7	2.0 (2.0)	0.5 (1.7)	0.6 (1.5)	2.2 (1.7)
China and Asian NIEs ^c	14	10.2 (10.2)	8.1 (8.9)	7.3 (7.6)	7.5 (7.4)
Others	37	6.6 (6.3)	5.5 (5.4)	4.5 (4.6)	5.5 (5.5)
World	100	5.0 (4.9)	3.7 (4.1)	2.8 (3.4)	4.6 (4.4)

- a. GDP shares are based on IMF estimates of the purchasing-power-parity (PPP) valuation of country GDPs for 2006. Source: IMF, *WEO Update*, January 2008.
- b. Numbers in parentheses are projections from the July 2008 *Monetary Policy Report Update*.
- c. NIEs are newly industrialized economies. These include Hong Kong (Special Administrative Region), South Korea, Taiwan (Province of China), and Singapore.

Source: Bank of Canada

Table 1

Outlook for the Canadian economy



Contributions to Annual Average GDP Growth Percentage points*

	2007	2008	2009	2010
Consumption	2.5 (2.5)	2.0 (2.1)	1.5 (2.3)	2.5 (2.4)
Housing	0.2 (0.2)	-0.2 (-0.1)	-0.6 (-0.1)	-0.3 (-0.1)
Government	0.9 (0.9)	1.0 (0.9)	0.7 (0.7)	0.6 (0.6)
Business fixed investment	0.5 (0.5)	0.2 (0.5)	-0.2 (0.5)	0.3 (0.5)
<i>Subtotal: Final domestic demand</i>	4.1 (4.1)	3.0 (3.4)	1.4 (3.4)	3.1 (3.4)
Exports	0.4 (0.4)	-1.5 (-1.1)	-0.6 (0)	1.5 (1.2)
Imports	-1.8 (-1.8)	-0.4 (-0.8)	-0.2 (-1.1)	-1.2 (-1.3)
<i>Subtotal: Net exports</i>	-1.4 (-1.4)	-1.9 (-1.9)	-0.8 (-1.1)	0.3 (-0.1)
Inventories	0 (0)	-0.5 (-0.5)	0 (0)	0 (0)
<i>GDP</i>	2.7 (2.7)	0.6 (1.0)	0.6 (2.3)	3.4 (3.3)
<i>Real Gross Domestic Income (GDI)</i>	3.7 (3.7)	2.0 (4.0)	-1.9 (4.4)	3.2 (3.3)

* Numbers in parentheses are from the base-case projection in the July *Monetary Policy Report Update*.

Table 2