



# Monetary Policy Report Summary

January 2010

*This text is a commentary of the Governing Council of the Bank of Canada. It presents the Bank's outlook based on information received up to 19 January 2010.*

The global economic recovery is under way, supported by continued improvements in financial conditions and stronger domestic demand growth in many emerging-market economies. While the outlook for global growth through 2010 and 2011 is somewhat stronger than the Bank had projected in its October *Monetary Policy Report*, the recovery continues to depend on exceptional monetary and fiscal stimulus, as well as extraordinary measures taken to support financial systems.

Economic growth in Canada resumed in the third quarter of 2009 and is expected to have picked up further in the fourth quarter. Total CPI inflation turned positive in the fourth quarter and the core rate of inflation has been slightly higher than expected in recent months. Nevertheless, considerable excess supply remains, and the Bank judges that the economy was operating about 3 1/4 per cent below its production capacity in the fourth quarter of 2009.

Canada's economic recovery is expected to evolve largely as anticipated in the October *Report*, with the economy returning to full capacity and inflation to the 2 per cent target in the third quarter of 2011. The Bank projects that the economy will grow by 2.9 per cent in 2010 and 3.5 per cent in 2011, after contracting by 2.5 per cent in 2009.

The factors shaping the recovery are largely unchanged—policy support, increased confidence, improving financial conditions, global growth, and higher terms of trade. At the same time, the persistent strength of the Canadian dollar and the low absolute level of U.S. demand continue to act as significant drags on economic activity in Canada. On balance, these factors have shifted the composition

## Highlights

- The global economic recovery is under way, and the outlook for global growth is somewhat stronger than in October.
- A recovery is also under way in Canada, but considerable excess supply remains.
- The Canadian economy is expected to return to full capacity and inflation to return to the 2 per cent target in the third quarter of 2011.
- The Canadian economy is projected to grow by 2.9 per cent in 2010 and 3.5 per cent in 2011, after having contracted by an estimated 2.5 per cent in 2009.
- The Bank reaffirmed its conditional commitment to hold its policy rate at 1/4 per cent until the end of the second quarter of 2010.
- As a result of monetary policy operating at the effective lower bound, the Bank judges that the overall risks to the inflation projection are tilted slightly to the downside.

of aggregate demand towards growth in domestic demand and away from net exports. The private sector should become the sole driver of domestic demand growth in 2011.

The main risks to the outlook for inflation are those identified in the October *Monetary Policy Report*. Risks remain elevated, although they have continued to diminish gradually with the consolidation of the recovery in the global and Canadian economies.

The main upside risks to inflation are associated with the possibility of a stronger-than-anticipated global recovery. It is possible that the recovery in global demand could be more vigorous than projected, resulting in stronger external demand for Canadian

exports. A related risk is that Canadian domestic demand could be more robust than projected.

On the downside, there is the risk that persistent strength of the Canadian dollar could act as a significant further drag on growth and put additional downward pressure on inflation. Another important downside risk is that the global recovery could be even more protracted than projected.

While the Bank judges that these underlying macro-economic risks are roughly balanced, the overall risks to the inflation projection are tilted slightly to the downside as a result of monetary policy operating at the effective lower bound.

### Projection for global economic growth

	Share of real global GDP <sup>a</sup> (per cent)	Projected growth (per cent) <sup>b</sup>			
		2008	2009	2010	2011
United States	21	0.4 (0.4)	-2.5 (-2.5)	2.5 (1.8)	3.9 (3.8)
Euro area	16	0.5 (0.5)	-3.9 (-3.9)	1.2 (0.9)	2.1 (2.4)
Japan	7	-1.2 (-0.7)	-5.3 (-5.7)	1.9 (1.7)	2.0 (2.5)
China	11	9.1 (9.1)	8.3 (8.1)	9.3 (8.9)	9.2 (8.9)
Rest of the world	45	4.0 (3.9)	-2.0 (-2.1)	4.0 (3.3)	4.0 (3.7)
<b>World</b>	<b>100</b>	<b>2.9 (2.9)</b>	<b>-1.5 (-1.6)</b>	<b>3.7 (3.1)</b>	<b>4.1 (4.0)</b>

a. GDP shares are based on IMF estimates of the purchasing-power-parity (PPP) valuation of country GDPs for 2007. Source: IMF, *WEO*, April 2009

b. Numbers in parentheses are projections used for the October 2009 *Monetary Policy Report*. Source: Bank of Canada

### Summary of the base-case projection for Canada<sup>a</sup>

	2008	2009				2010				2011			
	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Real GDP (quarter-over-quarter percentage change)	-3.7 (-3.7)	-6.2 (-6.1)	-3.1 (-3.4)	0.4 (2.0)	3.3 (3.3)	3.5 (3.8)	4.3 (3.8)	4.0 (3.7)	3.8 (3.5)	3.8 (3.3)	3.3 (3.3)	2.8 (2.8)	2.2 (2.5)
Real GDP (year-over-year percentage change)	-1.0 (-1.0)	-2.3 (-2.3)	-3.2 (-3.2)	-3.2 (-2.8)	-1.5 (-1.1)	1.0 (1.4)	2.9 (3.2)	3.8 (3.6)	3.9 (3.6)	4.0 (3.5)	3.7 (3.4)	3.4 (3.2)	3.0 (3.0)
Core inflation (year-over-year percentage change)	2.2 (2.2)	1.9 (1.9)	1.9 (1.9)	1.7 (1.7)	1.6 (1.4)	1.6 (1.4)	1.7 (1.5)	1.7 (1.5)	1.8 (1.7)	1.8 (1.8)	1.9 (1.9)	2.0 (2.0)	2.0 (2.0)
Total CPI (year-over-year percentage change)	2.0 (2.0)	1.2 (1.2)	0.1 (0.1)	-0.9 (-0.9)	0.9 (1.0)	1.6 (1.4)	1.8 (1.4)	1.8 (1.3)	1.9 (1.6)	1.9 (1.8)	1.9 (1.9)	2.0 (2.0)	2.0 (2.0)
WTI <sup>b</sup> (level)	58 (58)	43 (43)	60 (60)	68 (68)	76 (73)	81 (75)	83 (76)	84 (77)	86 (78)	87 (79)	88 (80)	88 (80)	89 (81)

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

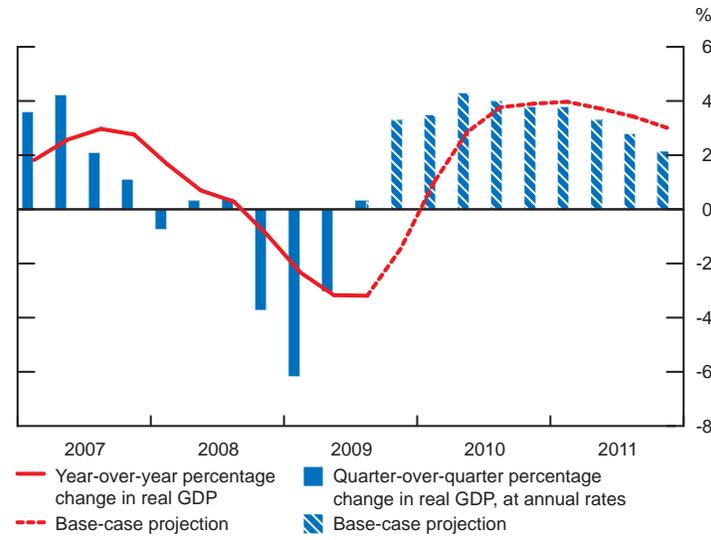
b. Assumptions for the price of West Texas Intermediate crude oil (US\$ per barrel), based on an average of futures contracts over the two weeks ending 15 January 2010.

Over the medium term, global macroeconomic imbalances continue to pose significant risks to the outlook.

On 8 December 2009 and 19 January 2010, the Bank reaffirmed its conditional commitment to maintain its target for the overnight rate at its current level of

1/4 per cent until the end of the second quarter of 2010 in order to achieve the inflation target. In its conduct of monetary policy at low interest rates, the Bank retains considerable flexibility, consistent with the framework outlined in the April 2009 *Monetary Policy Report*.

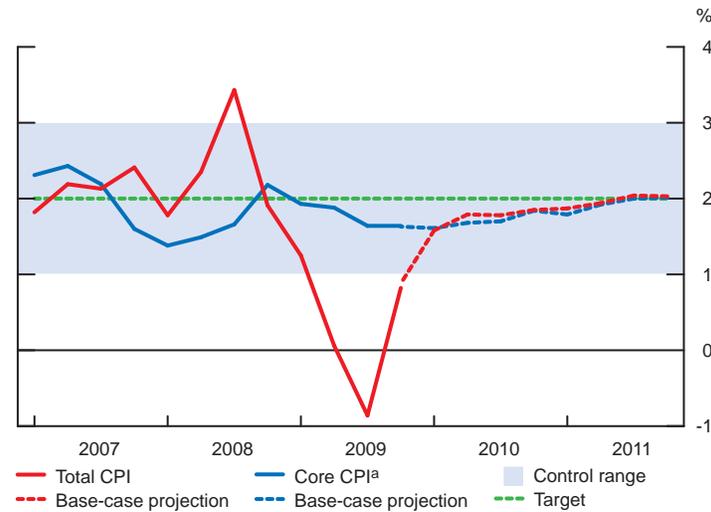
### Real GDP growth is expected to accelerate in 2010



Sources: Statistics Canada and Bank of Canada calculations

### Total CPI and core inflation in Canada are projected to return to 2 per cent in the third quarter of 2011

Year-over-year percentage change, quarterly data



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

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