



Monetary Policy Report Summary

July 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 the fixed announcement date on 20 July 2010.

The global economic recovery is proceeding but is not yet self-sustaining. Greater emphasis on balance sheet repair by households, banks, and governments in a number of advanced economies is expected to temper the pace of global growth relative to the Bank's outlook in April. While the policy response to the European sovereign debt crisis has reduced the risk of an adverse outcome and increased the prospect of sustainable long-term growth, it is expected to slow the global recovery over the projection horizon. In the United States, private demand is picking up but remains uneven.

Economic activity in Canada is unfolding largely as expected, led by government and consumer spending. Housing activity is declining markedly from high levels, consistent with the Bank's view that policy stimulus resulted in household expenditures being brought forward into late 2009 and early 2010. While employment growth has resumed, business investment appears to be held back by global uncertainties and has yet to recover from its sharp contraction during the recession.

The Bank expects the economic recovery in Canada to be more gradual than it had projected in April, with growth of 3.5 per cent in 2010, 2.9 per cent in 2011, and 2.2 per cent in 2012. This revision reflects a slightly weaker profile for global economic growth and more modest consumption growth in Canada. The Bank anticipates that business investment and net exports will make a relatively larger contribution to growth.

Inflation in Canada has been broadly in line with the Bank's April projection. While the Bank now expects the economy to return to full capacity at the end of

Highlights

- The global economic recovery is proceeding but is not yet self-sustaining.
- The economic recovery in Canada is expected to be more gradual, with growth of 3.5 per cent in 2010, 2.9 per cent in 2011, and 2.2 per cent in 2012.
- The Canadian economy is expected to return to full capacity at the end of 2011, and inflation is expected to remain near 2 per cent throughout the projection period.
- On 20 July 2010, the Bank raised its target for the overnight rate by one-quarter of one percentage point to 3/4 per cent.
- The Bank judges that the risks to the inflation outlook remain elevated and are roughly balanced over the projection horizon.

2011, two quarters later than had been anticipated in April, the underlying dynamics for inflation are little changed. Both total CPI and core inflation are expected to remain near 2 per cent throughout the projection period. The Bank will look through the transitory effects on inflation of changes to provincial indirect taxes.

The risks around this projection remain elevated and are judged to be roughly balanced over the projection horizon. Globally, on the upside, the boost in confidence as advanced countries restore fiscal sustainability could generate greater-than-expected offsets to the fiscal consolidation. On the downside, global private demand around the world, including in the United States, may be insufficient to sustain the recovery.

In Canada, there are important two-sided risks to the outlook for private demand. On the upside, private demand might have greater momentum than expected, reflecting strong confidence and easy credit conditions. On the downside, it is possible that households reduce expenditures more than currently anticipated or that the recovery in business investment is further delayed.

Since April 2010, with improvements in the economy, the Bank has ended its extraordinary conduct of monetary policy. On 20 April 2010, the Bank removed its conditional commitment, which had provided considerable additional stimulus during a period of very weak economic conditions and major downside risks to the global and Canadian economies.

Projection for global economic growth

	Share of real global GDP ^a (per cent)	Projected growth (per cent) ^b		
		2010	2011	2012
United States	21	2.9 (3.1)	3.0 (3.5)	3.5 (3.5)
Euro area	15	1.0 (1.2)	1.2 (1.6)	2.3 (2.5)
Japan	6	3.3 (2.1)	1.5 (1.7)	2.5 (2.6)
China	13	10.3 (10.2)	9.2 (9.3)	8.7 (8.7)
Rest of the world	45	5.1 (4.5)	3.8 (4.1)	3.6 (3.9)
World	100	4.6 (4.2)	3.8 (4.0)	4.0 (4.1)

a. GDP shares are based on IMF estimates of the purchasing-power-parity (PPP) valuation of country GDPs for 2009.

Source: IMF, *WEO*, April 2010

b. Numbers in parentheses are projections used for the April 2010 *Monetary Policy Report*.

Source: Bank of Canada

Summary of the base-case projection for Canada^a

	2009	2010				2011				2012			
	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Real GDP (quarter-over-quarter percentage change at annual rates)	4.9 (5.0)	6.1 (5.8)	3.0 (3.8)	2.8 (3.5)	3.2 (3.5)	3.0 (3.3)	3.0 (2.8)	2.5 (1.9)	2.4 (1.9)	2.0 (1.9)	1.9 (1.9)	1.9 (1.9)	1.9 (1.9)
Real GDP (year-over-year percentage change)	-1.1 (-1.2)	2.2 (2.0)	3.7 (3.9)	4.2 (4.5)	3.8 (4.2)	3.0 (3.6)	3.0 (3.3)	2.9 (2.9)	2.7 (2.5)	2.5 (2.1)	2.2 (1.9)	2.1 (1.9)	2.0 (1.9)
Core inflation (year-over-year percentage change)	1.6 (1.6)	2.0 (2.0)	1.9 (1.9)	1.8 (1.8)	1.8 (1.8)	1.8 (1.7)	1.7 (1.7)	1.8 (1.9)	1.9 (2.0)	2.0 (2.0)	2.0 (2.0)	2.0 (2.0)	2.0 (2.0)
Total CPI (year-over-year percentage change)	0.8 (0.8)	1.6 (1.7)	1.4 (1.7)	2.1 (2.4)	2.1 (2.4)	2.2 (2.4)	2.2 (2.3)	1.8 (1.9)	2.0 (2.0)	2.0 (2.0)	2.0 (2.0)	2.0 (2.0)	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)	1.6 (1.7)	1.4 (1.7)	1.7 (2.0)	1.8 (2.1)	1.8 (2.1)	1.8 (2.0)	1.8 (2.0)	1.9 (2.0)	2.0 (2.0)	2.0 (2.0)	2.0 (2.0)	2.0 (2.0)
WTI ^b (level)	76 (76)	79 (79)	78 (86)	75 (88)	77 (89)	78 (89)	80 (90)	80 (90)	81 (90)	81 (91)	81 (91)	82 (91)	82 (91)

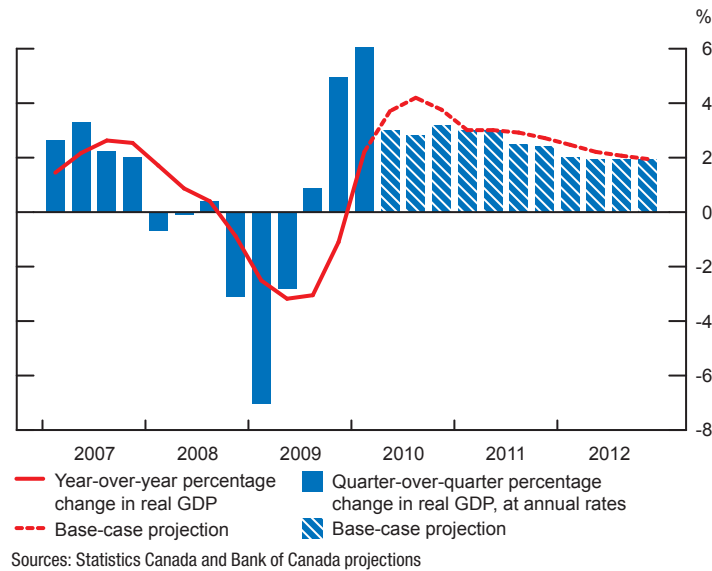
a. Figures in parentheses are from the base-case projection in the April *Monetary Policy Report*.

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 16 July 2010.

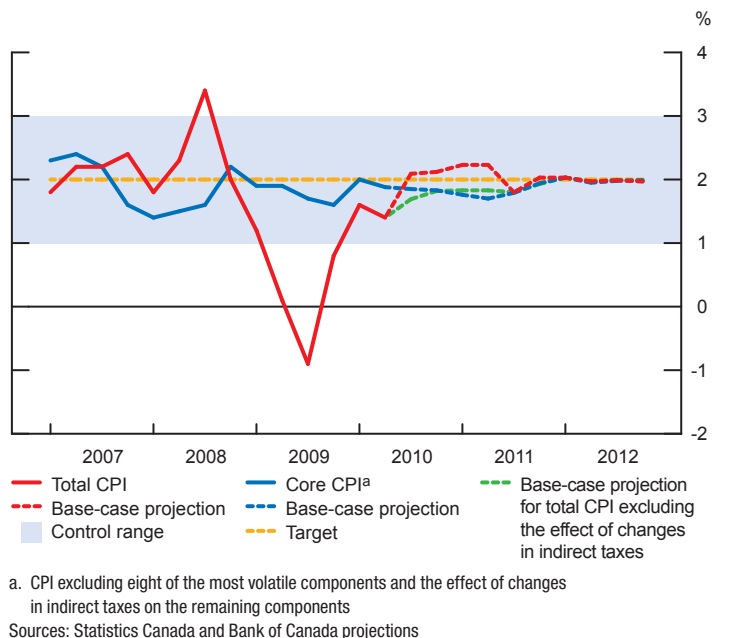
On 1 June 2010, the Bank raised its target for the overnight rate by one-quarter of one percentage point to 1/2 per cent. As part of that interest rate decision, the Bank re-established its normal operating framework for the implementation of monetary policy, resetting the target for the overnight rate at the midpoint of the operating band and the width of the operating band to 50 basis points. On 20 July 2010, the Bank raised its target for the overnight rate by a further one-quarter of one percentage point to 3/4 per cent.

These decisions leave considerable monetary stimulus in place, consistent with achieving the 2 per cent inflation target in light of the significant excess supply in Canada, the strength of domestic spending, and the uneven global recovery. Given the considerable uncertainty surrounding the outlook, any further reduction of monetary stimulus would have to be weighed carefully against domestic and global economic developments.

Real GDP growth is expected to moderate to the rate of potential output growth



Total CPI and core inflation in Canada are projected to remain close to the 2 per cent target over the projection horizon
 Year-over-year percentage change, quarterly data



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* Available only on the Bank's website

The Bank of Canada's *Monetary Policy Report* is published quarterly in January, April, July, and October. Copies of the *Report* and the *Summary* may be obtained by contacting Publications Distribution, Communications Department, Bank of Canada, Ottawa, Ontario, Canada K1A 0G9.

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