



Monetary Policy Report Summary

January 2012

This text is a commentary of the Governing Council of the Bank of Canada. It presents the Bank's outlook based on data received up to 13 January 2012.

The outlook for the global economy has deteriorated and uncertainty has increased since October. The sovereign debt crisis in Europe has intensified, conditions in international financial markets have tightened and risk aversion has risen. The recession in Europe is now expected to be deeper and longer than the Bank had anticipated. The Bank continues to assume that European authorities will implement sufficient measures to contain the crisis, although this assumption is clearly subject to downside risks. In the United States, while the rebound in real GDP during the second half of 2011 was stronger than anticipated, the Bank expects the recovery will proceed at a more modest pace going forward, owing to ongoing household deleveraging, fiscal consolidation and the spillovers from Europe. Chinese growth is decelerating, as expected, toward a more sustainable pace. Commodity prices—with the exception of oil—are expected to be below the levels anticipated in October through 2013.

The Bank's overall outlook for the Canadian economy is little changed from October. While the economy had more momentum than anticipated in the second half of 2011, the pace of growth going forward is expected to be more modest than previously envisaged, largely due to the external environment. Prolonged uncertainty about the global economic and financial environment is likely to dampen the rate of growth of business investment, albeit to a still-solid pace. Net exports are expected to contribute little to growth, reflecting moderate foreign demand and ongoing competitiveness challenges, including the persistent strength of the Canadian dollar. In contrast, very favourable financing conditions are expected to buttress consumer spending and housing activity. Household expenditures are expected to remain high relative to GDP and the ratio of household debt to income is projected to rise further.

Highlights

- The outlook for the global economy has deteriorated and uncertainty has increased since October.
- The overall outlook for the Canadian economy is little changed from October. While there was more momentum than anticipated in the second half of 2011, the pace of growth going forward is expected to be more modest than previously envisaged.
- The Canadian economy is estimated to have grown by 2.4 per cent in 2011 and is projected to grow by 2.0 per cent in 2012 and 2.8 per cent in 2013. It is anticipated to return to full capacity by the third quarter of 2013.
- Both total and core inflation are expected to moderate in 2012 and subsequently rise, reaching 2 per cent by the third quarter of 2013.
- On 6 December 2011 and 17 January 2012, the Bank maintained the target for the overnight rate at 1 per cent.

The Bank estimates that the economy grew by 2.4 per cent in 2011 and projects that it will grow by 2.0 per cent in 2012 and 2.8 per cent in 2013. While the economy appears to be operating with less slack than previously assumed, given the more modest growth profile, the economy is only anticipated to return to full capacity by the third quarter of 2013, one quarter earlier than was expected in October.

The dynamics for inflation are similar to those anticipated in October, although the profile for inflation is marginally firmer. Both total and core inflation are expected to moderate in 2012 and subsequently rise, reaching 2 per cent by the third quarter of 2013 as excess supply is slowly absorbed, labour compensation grows modestly and inflation expectations remain well-anchored.

Several significant upside and downside risks are present in the inflation outlook for Canada.

Projection for global economic growth

	Share of real global GDP ^a (per cent)	Projected growth (per cent) ^b			
		2010	2011	2012	2013
United States	21	3.0 (3.0)	1.8 (1.7)	2.0 (1.7)	2.2 (3.3)
Euro area	16	1.8 (1.7)	1.5 (1.5)	-1.0 (0.2)	0.9 (1.5)
Japan	6	4.5 (4.0)	-0.8 (-0.6)	1.9 (2.0)	1.7 (2.5)
China	11	10.4 (10.4)	9.1 (9.1)	8.2 (8.2)	8.0 (8.2)
Rest of the world	46	5.8 (5.7)	4.2 (4.3)	3.1 (3.3)	3.2 (3.4)
World	100	5.2 (5.1)	3.7 (3.8)	2.9 (3.1)	3.3 (3.7)

a. GDP shares are based on IMF estimates of the purchasing-power-parity (PPP) valuation of country GDPs for 2010. Source: IMF, WEO, September 2011

b. Numbers in parentheses are projections used for the October 2011 *Monetary Policy Report*. Source: Bank of Canada

Summary of the base-case projection for Canada^a

	2010	2011				2012				2013			
	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Real GDP (quarter-over-quarter percentage change at annual rates)	3.1 (3.1)	3.5 (3.6)	-0.5 (-0.4)	3.5 (2.0)	2.0 (0.8)	1.8 (1.9)	1.8 (2.5)	2.1 (3.0)	2.6 (3.0)	3.1 (3.0)	3.1 (3.0)	3.0 (3.0)	2.8 (3.0)
Real GDP (year-over-year percentage change)	3.3 (3.3)	2.8 (2.9)	2.1 (2.2)	2.4 (2.1)	2.1 (1.5)	1.7 (1.1)	2.3 (1.8)	1.9 (2.1)	2.1 (2.6)	2.4 (2.9)	2.7 (3.0)	2.9 (3.0)	3.0 (2.9)
Core inflation (year-over-year percentage change)	1.6 (1.6)	1.3 (1.3)	1.6 (1.6)	1.9 (1.9)	2.2 (2.0)	2.1 (1.8)	2.0 (1.7)	1.9 (1.7)	1.7 (1.6)	1.9 (1.8)	1.9 (1.9)	2.0 (1.9)	2.0 (2.0)
Total CPI (year-over-year percentage change)	2.3 (2.3)	2.6 (2.6)	3.4 (3.4)	3.0 (3.0)	2.8 (2.7)	2.2 (1.9)	1.5 (1.0)	1.7 (1.2)	1.7 (1.5)	1.8 (1.8)	1.9 (1.9)	2.0 (1.9)	2.0 (2.0)
Total CPI excluding the effect of the HST and changes in other indirect taxes (year-over-year percentage change)	1.9 (1.9)	2.1 (2.1)	2.9 (2.9)	3.0 (3.0)	2.7 (2.6)	2.1 (1.9)	1.4 (1.0)	1.6 (1.2)	1.6 (1.5)	1.8 (1.8)	1.9 (1.9)	2.0 (1.9)	2.0 (2.0)
WTI ^b (level)	85 (85)	94 (94)	103 (103)	90 (90)	94 (85)	101 (87)	102 (87)	102 (87)	101 (88)	100 (88)	99 (88)	98 (88)	98 (88)

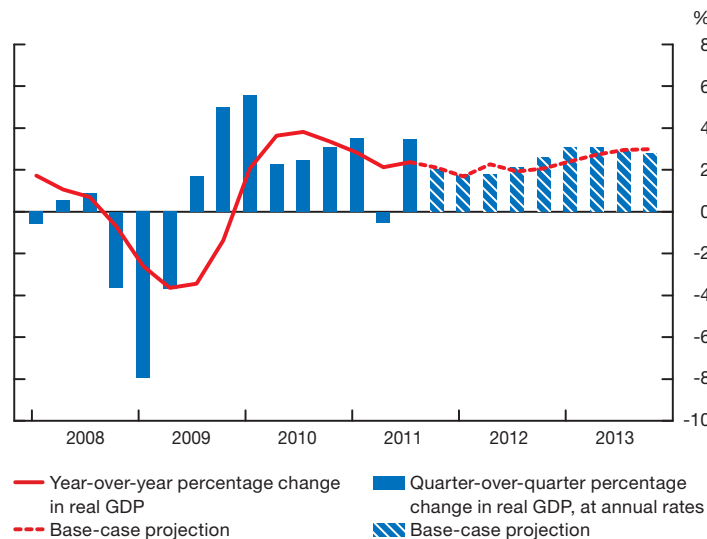
a. Figures in parentheses are from the base-case projection in the October 2011 *Monetary Policy Report*.

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 13 January 2012.

The three main upside risks to inflation in Canada relate to the possibility of stronger-than-expected inflationary pressures in the global economy, stronger-than-expected growth in the U.S. economy and stronger momentum in Canadian household spending.

The two main downside risks to inflation in Canada relate to sovereign debt and banking concerns in Europe and the possibility that growth in Canadian household spending could be weaker than projected.

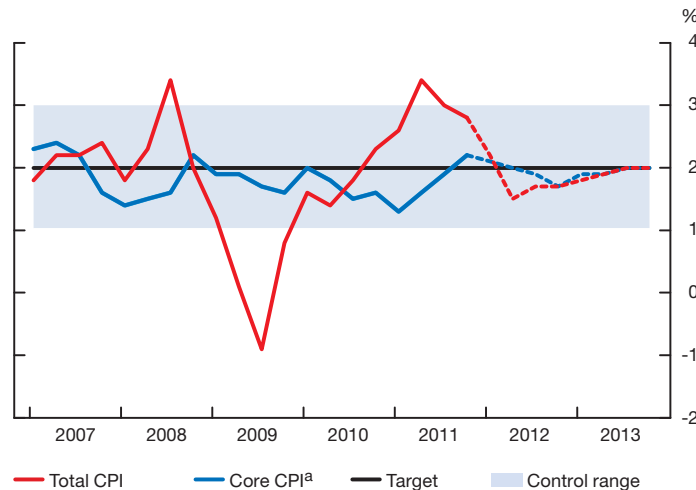
Real GDP growth is expected to pick up in the second half of 2012, resulting in a gradual absorption of excess supply



Sources: Statistics Canada and Bank of Canada projections

Total and core CPI inflation in Canada are projected to fall temporarily below 2 per cent in 2012

Year-over-year percentage change, quarterly data



Note: Dotted lines indicate projections.

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 and projections

Overall, the Bank judges that these risks are roughly balanced over the projection horizon.

Reflecting all of these factors, on 17 January, the Bank maintained the target for the overnight rate at 1 per cent. With the target interest rate near historic lows and the financial system functioning well, there is considerable monetary policy stimulus in Canada. The Bank will continue to monitor carefully economic and financial developments in the Canadian and global economies, together with the evolution of risks, and set monetary policy consistent with achieving the 2 per cent inflation target over the medium term.

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