



Monetary Policy Report Summary

October 2014

This text is a commentary of the Governing Council of the Bank of Canada.

Highlights

- **Inflation in Canada is close to the 2 per cent target. Underlying inflationary pressures are muted, given the persistent slack in the economy and the continued effects of competition in the retail sector.**
- **The outlook is for stronger momentum in the global economy. However, the profile is weaker than in July and is diverging across regions. Growth remains reliant on exceptional monetary policy stimulus.**
- **Canada's real GDP growth is projected to average close to 2 1/2 per cent over the next year before slowing gradually to 2 per cent by the end of 2016.**
- **As the economy reaches full capacity in the second half of 2016, inflation is projected to be about 2 per cent on a sustained basis.**

Inflation in Canada is close to the 2 per cent target. Core inflation rose more rapidly than was expected in July, mainly reflecting unexpected sector-specific factors. Total CPI inflation is evolving broadly as expected, as the pickup in core inflation was largely offset by lower energy prices. Underlying inflationary pressures are muted, given the persistent slack in the economy and the continued effects of competition in the retail sector.

Although the outlook remains for stronger momentum in the global economy in 2015 and 2016, the profile is weaker than in July and growth prospects are diverging across regions. Persistent headwinds continue to buffet most economies and growth remains reliant on exceptional policy stimulus. Against a background of ongoing geopolitical uncertainties and lower confidence, energy prices have declined and there has been a significant correction in global financial markets, resulting in lower government bond yields. Despite weakness elsewhere, the U.S. economy is gaining traction, particularly in sectors that are beneficial to Canada's export prospects. The U.S. dollar has strengthened against other major currencies, including the Canadian dollar.

In this context, Canada's exports have begun to respond. However, business investment remains weak. Meanwhile, the housing market and consumer spending are showing renewed vigour and auto sales have reached record highs, all fuelled by very low borrowing rates. The lower terms of trade will have a tempering effect on income.

Canada's real GDP growth is projected to average close to 2 1/2 per cent over the next year before slowing gradually to 2 per cent by the end of 2016, roughly the estimated growth rate of potential output. As global headwinds recede, confidence in the sustainability of domestic and global demand should improve and business investment should pick up. Together with a moderation in the growth of household spending, this is expected to gradually return Canada's economy to a more balanced growth path. As the economy reaches its full capacity in the second half of 2016, both core and total CPI inflation are projected to be about 2 per cent on a sustained basis.

The outlook for inflation is subject to several risks emanating from both the external environment and the domestic economy. The most important risks to inflation are stronger U.S. private demand, further disappointment in global growth, lower oil prices, weaker Canadian exports and business investment, and stronger household spending in Canada.

Weighing all of these factors, the Bank judges that the risks to its inflation projection are roughly balanced. Meanwhile, the financial stability risks associated with household imbalances are edging higher. Overall, the balance of risks falls within the zone for which the current stance of monetary policy is appropriate and therefore the target for the overnight rate remains at 1 per cent.

Projection for global economic growth

	Share of real global GDP ^a (per cent)	Projected growth ^b (per cent)			
		2013	2014	2015	2016
United States	16	2.2 (1.9)	2.2 (1.6)	2.9 (3.1)	2.7 (3.0)
Euro area	12	-0.4 (-0.4)	0.8 (0.9)	0.8 (1.4)	1.0 (1.7)
Japan	5	1.5 (1.5)	0.8 (1.3)	0.7 (1.2)	0.8 (1.0)
China	16	7.7 (7.7)	7.4 (7.2)	7.0 (7.0)	6.9 (7.1)
Rest of the world	51	2.9 (2.9)	2.9 (2.9)	3.2 (3.7)	3.4 (3.8)
World	100	3.0 (3.0)	3.1 (3.0)	3.4 (3.7)	3.5 (3.8)

a. GDP shares are based on International Monetary Fund (IMF) estimates of the purchasing-power-parity (PPP) valuation of country GDPs for 2013 from the IMF's October 2014 *World Economic Outlook*. This update has increased the weight of China and the rest of the world, which in turn has revised up World GDP growth by approximately 0.1 percentage points relative to the July *Report*.

Source: IMF, *World Economic Outlook*, October 2014

b. Numbers in parentheses are projections used for the July 2014 *Monetary Policy Report*, but World GDP growth is reweighted to reflect updated GDP shares.

Source: Bank of Canada

Summary of the projection for Canada^a

	2013	2014				2015				2016			
	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Real GDP (quarter-over-quarter percentage change at annual rates)	2.7 (2.7)	0.9 (1.2)	3.1 (2.5)	2.3 (2.3)	2.5 (2.4)	2.4 (2.5)	2.4 (2.5)	2.4 (2.3)	2.4 (2.3)	2.3 (2.3)	2.3 (2.3)	2.2 (2.1)	2.0 (1.9)
Real GDP (year-over-year percentage change)	2.7 (2.7)	2.1 (2.2)	2.5 (2.4)	2.3 (2.2)	2.2 (2.1)	2.6 (2.4)	2.4 (2.5)	2.4 (2.5)	2.4 (2.4)	2.4 (2.4)	2.4 (2.3)	2.3 (2.3)	2.2 (2.2)
Core inflation (year-over-year percentage change)	1.2 (1.2)	1.3 (1.3)	1.7 (1.6)	2.0 (1.7)	2.1 (1.8)	1.9 (1.6)	1.8 (1.6)	1.7 (1.7)	1.8 (1.8)	1.9 (1.9)	1.9 (1.9)	1.9 (2.0)	2.0 (2.0)
Total CPI (year-over-year percentage change)	0.9 (0.9)	1.4 (1.4)	2.2 (2.1)	2.0 (2.0)	2.2 (2.2)	1.6 (2.0)	1.4 (1.7)	1.5 (1.8)	1.8 (1.9)	1.9 (2.0)	1.9 (2.0)	1.9 (2.0)	2.0 (2.0)

a. Numbers in parentheses are from the base-case projection in the July 2014 *Monetary Policy Report*. Assumptions for the price for crude oil are based on a recent average of spot prices.

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