BANK OF CANADA
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# Monetary Policy Report Summary

July 2015

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

## Highlights

- On 15 July, the Bank lowered the overnight rate target to 1/2 per cent.
- Total CPI inflation in Canada has been around 1 per cent; core inflation has been close to 2 per cent.
- Global growth faltered in early 2015. It is expected to strengthen over the second half of 2015, averaging about 3 per cent for the year, and accelerate to around 3 1/2 per cent in 2016 and 2017.
- The projection for growth in Canada in 2015 has been marked down, with real GDP estimated to have contracted modestly in the first half of the year. Growth in Canada is projected to resume in the third quarter and begin to exceed potential again in the fourth quarter.
- The Bank expects real GDP growth of just over 1 per cent in 2015 and about 2 1/2 per cent in 2016 and 2017.
- The Bank anticipates that the economy will return to full capacity and inflation to 2 per cent on a sustained basis in the first half of 2017.

Total CPI inflation in Canada has been around 1 per cent in recent months, reflecting year-over-year price declines for consumer energy products. Core inflation has been close to 2 per cent, with disinflationary pressures from economic slack being offset by transitory effects of the past depreciation of the Canadian dollar and some sector-specific factors. Setting aside these transitory effects, the Bank judges that the underlying trend in inflation is about 1.5 to 1.7 per cent.

Global growth faltered in early 2015, principally in the United States and China. Recent indicators suggest a rebound in the U.S. economy in the second half of this year, and growth is expected to be solid through the projection. In contrast, China is slowing amid an ongoing process of rebalancing to a more sustainable growth path. This has pulled down prices of certain commodities that are important to Canada's exports. Financial conditions in major economies remain very accommodative and continue to provide much-needed support to economic activity. Global growth is expected to strengthen over the second half of 2015, averaging about 3 per cent for the year, and accelerate to around 3 1/2 per cent in 2016 and 2017.

The Bank's estimate of growth in Canada in 2015 has been marked down considerably from its April projection. The downward revision reflects further downgrades of business investment plans in the energy sector, as well as weaker-than-expected exports of non-energy commodities and non-commodities. Real GDP is now projected to have contracted modestly in the first half of the year, resulting in higher excess capacity and additional downward pressure on inflation.

The Bank expects growth to resume in the third quarter and begin to exceed potential again in the fourth quarter, led by the non-resource sectors of Canada's economy. Outside the energy-producing regions, consumer confidence remains high and labour markets continue to improve. This will support consumption, which will also receive a fiscal boost. Recent evidence suggests a pickup in activity and rising capacity pressures among manufacturers, particularly those exporters that are most sensitive to movements in the Canadian dollar. Financial conditions for households and businesses remain very stimulative.

The Bank now projects Canada's real GDP will grow by just over 1 per cent in 2015 and about 2 1/2 per cent in 2016 and 2017. With this revised growth profile, the output gap is significantly larger than was expected in April, and closes somewhat later. The Bank anticipates that the economy will return to full capacity and inflation to 2 per cent on a sustained basis in the first half of 2017.

The lower outlook for Canadian growth has increased the downside risks to inflation. While vulnerabilities associated with household imbalances remain elevated and could edge higher, Canada's economy is undergoing a significant and complex adjustment. Additional monetary stimulus is required at this time to help return the economy to full capacity and inflation sustainably to target. Taking all this into consideration, on 15 July, the Bank lowered the overnight rate target to 1/2 per cent.

Following this action, the Bank judges that the risks to the outlook for inflation are roughly balanced. Emanating from both the external environment and the domestic economy, the most important risks are:

- larger decline in investment in the oil and gas sector;
- weaker Canadian non-energy exports;
- imbalances in the Canadian household sector; and,
- stronger U.S. private demand.

## Projection for global economic growth

| | Share of real global GDP[a] (per cent) | Projected growth[b] (per cent) | | | |
|---|---|---|---|---|---|
| | | 2014 | 2015 | 2016 | 2017 |
| **United States** | 16 | 2.4 (2.4) | 2.3 (2.7) | 2.8 (3.0) | 2.6 (2.6) |
| **Euro area** | 12 | 0.9 (0.9) | 1.2 (1.2) | 1.3 (1.3) | 1.4 (1.3) |
| **Japan** | 5 | -0.1 (-0.1) | 0.8 (0.4) | 1.2 (1.5) | 1.2 (1.3) |
| **China** | 16 | 7.4 (7.4) | 6.8 (6.9) | 6.6 (6.8) | 6.4 (6.5) |
| **Oil-importing EMEs[c]** | 32 | 3.8 | 3.6 | 4.1 | 4.4 |
| **Rest of the world[d]** | 19 | 2.9 | 1.8 | 3.2 | 3.2 |
| **World** | 100 | 3.4 (3.3) | 3.1 (3.3) | 3.6 (3.6) | 3.7 (3.6) |
| ***Reference: Rest of the world (April* Report*)[e]*** | *51* | *3.5 (3.3)* | *2.9 (3.1)* | *3.7 (3.5)* | *4.0 (3.7)* |

a. GDP shares are based on International Monetary Fund (IMF) estimates of the purchasing-power-parity valuation of country GDPs for 2013 from the IMF's October 2014 *World Economic Outlook*.
b. Numbers in parentheses are projections used for the Bank's April 2015 *Monetary Policy Report*.
c. The oil-importing emerging-market economies (EMEs) grouping excludes China. The group was formed by removing oil-importing emerging markets from the rest-of-the-world group as it was presented at the time of the April *Report*. It includes large emerging markets from Asia, Latin America, the Middle East and Africa (such as India, Brazil and South Africa), as well as newly industrialized economies (such as South Korea).
d. "Rest of the world" is a grouping of all other economies not included in the first five regions—the United States, the euro area, Japan, China and oil-importing EMEs (excluding China). It is composed of oil-exporting emerging markets (such as Russia, Nigeria and Saudi Arabia) and other advanced economies (such as the United Kingdom, Canada and Australia).
e. The "Rest of the world" as it was presented in the April *Report*. The numbers in parentheses represent the growth rate of the rest of the world at the time of the April *Report*, and the current growth rates represent the weighted average of the new regions: Oil-importing EMEs and the Rest of the world.

Source: Bank of Canada

## Summary of the projection for Canada[a]

| | 2014 | 2015 | | | | 2016 | | | | 2017 | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Q4 | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 |
| **Real GDP (quarter-over-quarter percentage change at annual rates)** | 2.2 (2.4) | -0.6 (0.0) | -0.5 (1.8) | 1.5 (2.8) | 2.5 (2.5) | 2.6 (2.5) | 2.8 (2.5) | 2.9 (2.3) | 2.9 (2.1) | 2.8 (2.0) | 2.5 (1.9) | 2.2 (1.8) | 1.8 (1.8) |
| **Real GDP (year-over-year percentage change)** | 2.5 (2.6) | 2.1 (2.4) | 1.1 (1.9) | 0.7 (1.8) | 0.7 (1.8) | 1.5 (2.4) | 2.3 (2.6) | 2.7 (2.5) | 2.8 (2.4) | 2.8 (2.2) | 2.8 (2.1) | 2.6 (1.9) | 2.3 (1.9) |
| **Core inflation (year-over-year percentage change)** | 2.2 (2.2) | 2.2 (2.1) | 2.2 (2.1) | 2.1 (2.0) | 2.0 (2.1) | 2.0 (2.1) | 1.9 (2.1) | 1.8 (2.0) | 1.9 (2.0) | 1.9 (2.0) | 2.0 (2.0) | 2.0 (2.0) | 2.0 (2.0) |
| **Total CPI (year-over-year percentage change)** | 2.0 (2.0) | 1.0 (1.0) | 0.9 (0.8) | 1.2 (0.9) | 1.4 (1.4) | 2.1 (2.1) | 1.9 (2.1) | 1.8 (2.0) | 1.9 (2.0) | 1.9 (2.0) | 2.0 (2.0) | 2.0 (2.0) | 2.0 (2.0) |

a. Numbers in parentheses are from the projection in the April 2015 *Monetary Policy Report*. Assumptions for the price for crude oil are based on the average of spot prices since the end of May.

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