

Monetary Policy Report Summary

July 2014

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

Highlights

- Recent higher inflation is attributable to the temporary effects of higher energy prices, exchange rate pass-through and other sector-specific shocks, rather than to any change in domestic economic fundamentals. Over the next two years, inflation is projected to fluctuate around 2 per cent.
- The global economy is on a lower growth track than anticipated in April. Nevertheless, the Bank continues to project that global growth will gather momentum as headwinds abate.
- Economic activity in Canada is projected to be a little weaker than previously expected. Real GDP growth is projected to average around 2 1/4 per cent during 2014 – 2016 and the economy is expected to reach full capacity and inflation to converge sustainably at target around mid-2016.

Total CPI inflation has moved up to around the 2 per cent target in recent months, sooner than expected. Core inflation has also increased but remains below 2 per cent. Recent higher inflation is attributable to the temporary effects of higher energy prices, exchange rate pass-through and other sector-specific shocks, rather than to any change in domestic economic fundamentals. Over the next two years, inflation is projected to fluctuate around 2 per cent as these temporary effects ease and the downward pressure on inflation from economic slack and heightened retail competition gradually dissipates.

The global economy is on a lower growth track than was foreseen at the time of the April *Monetary Policy Report*. Serial disappointment with economic performance during the past several years has mainly reflected the impact of private-sector deleveraging, fiscal consolidation and, especially, the lingering effect of uncertainty on business investment and trade. Nevertheless, the Bank continues to project that global growth will gather momentum as these headwinds abate.

Given the downgrade to the global outlook, economic activity in Canada is now projected to be a little weaker than previously forecast. However, the Bank still expects that the lower Canadian dollar and a projected strengthening in global demand will lead to a pickup in Canadian exports and business investment and, eventually, a more sustainable growth track. Meanwhile, household imbalances continue to evolve constructively and recent data are broadly consistent with a soft landing in Canada's housing market. Real GDP growth is projected to average around 2 1/4 per cent during 2014–2016. Consequently, the economy is expected to reach full capacity around mid-2016, a little later than anticipated in April.

For the inflation target to be achieved on a sustained basis in 2016, the economy must reach and remain at full capacity. Closing the output gap over the time frame described above is reliant on continued stimulative monetary policy and hinges critically on stronger exports and business investment. Meanwhile, the risks associated with household imbalances, while evolving in a constructive way, are still elevated. Weighing these considerations within the Bank's risk-management framework, the monetary policy stance remains appropriate and the target for the overnight rate remains at 1 per cent. The Bank is neutral with respect to the timing and direction of the next change to the policy rate, which will depend on how new information influences the outlook and assessment of risks.

Projection for global economic growth

	Share of real global GDP ^a (per cent)	Projected growth ^b (per cent)			
		2013	2014	2015	2016
United States	20	1.9 (1.9)	1.6 (2.8)	3.1 (3.2)	3.0 (3.0)
Euro area	14	-0.4 (-0.4)	0.9 (1.1)	1.4 (1.3)	1.7 (1.6)
Japan	5	1.5 (1.5)	1.3 (1.2)	1.2 (1.3)	1.0 (1.0)
China	15	7.7 (7.7)	7.2 (7.3)	7.0 (7.3)	7.1 (7.2)
Rest of the world	47	2.9 (2.9)	2.9 (3.2)	3.7 (3.8)	3.8 (3.8)
World	100	2.9 (2.9)	2.9 (3.3)	3.6 (3.7)	3.7 (3.7)

a. GDP shares are based on International Monetary Fund (IMF) estimates of the purchasing-power-parity (PPP) valuation of country GDPs for 2012. The individual shares may not add up to 100 owing to rounding.

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

b. Numbers in parentheses are projections used for the April 2014 *Monetary Policy Report*.

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 (2.9)	1.2 (1.5)	2.5 (2.5)	2.3 (2.6)	2.4 (2.5)	2.5 (2.5)	2.5 (2.4)	2.3 (2.4)	2.3 (2.3)	2.3 (2.2)	2.3 (2.1)	2.1 (2.0)	1.9 (2.0)
Real GDP (year-over-year percentage change)	2.7 (2.7)	2.2 (2.3)	2.4 (2.4)	2.2 (2.4)	2.1 (2.3)	2.4 (2.5)	2.5 (2.5)	2.5 (2.4)	2.4 (2.4)	2.4 (2.3)	2.3 (2.2)	2.3 (2.1)	2.2 (2.1)
Core inflation (year-over-year percentage change)	1.2 (1.2)	1.3 (1.2)	1.6 (1.2)	1.7 (1.4)	1.8 (1.6)	1.6 (1.6)	1.6 (1.7)	1.7 (1.8)	1.8 (1.9)	1.9 (2.0)	1.9 (2.0)	2.0 (2.0)	2.0 (2.0)
Total CPI (year-over-year percentage change)	0.9 (0.9)	1.4 (1.3)	2.1 (1.6)	2.0 (1.8)	2.2 (1.9)	2.0 (2.0)	1.7 (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)
Total CPI excluding the effect of the HST and changes in other indirect taxes (year-over-year percentage change)	1.0 (1.0)	1.5 (1.4)	2.0 (1.5)	2.0 (1.8)	2.2 (1.9)	2.0 (2.0)	1.7 (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)

a. Numbers in parentheses are from the base-case projection in the April 2014 *Monetary Policy Report*. Assumptions for the price of crude oil are based on an average of spot prices since the June fixed announcement date.

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