



Monetary Policy Report Summary

October 2009

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 20 October 2009.

Recent indicators point to the start of a global recovery from a deep, synchronous recession. Global economic and financial developments have been somewhat more favourable than expected at the time of the *July Report*, although significant fragilities remain.

A recovery in economic activity is also under way in Canada. This resumption of growth is supported by monetary and fiscal stimulus, increased household wealth, improving financial conditions, higher commodity prices, and stronger business and consumer confidence. However, heightened volatility and persistent strength in the Canadian dollar are working to slow growth and subdue inflation pressures. The current strength in the dollar is expected, over time, to more than fully offset the favourable developments since July.

Given all of these factors, the Bank now projects that, relative to the *July Report*, the composition of aggregate demand will shift further towards final domestic demand and away from net exports. Growth is expected to be slightly higher in the second half of this year than previously projected but to average slightly lower over the balance of the projection period. The Canadian economy is projected to grow by 3.0 per cent in 2010 and 3.3 per cent in 2011, after contracting by 2.4 per cent this year. This is a somewhat more modest recovery in Canada than the average of previous economic cycles.

Highlights

- Recent indicators point to the start of a global economic recovery, although significant fragilities remain.
- A recovery in economic activity is also under way in Canada, although the current strength in the Canadian dollar is expected, over time, to more than fully offset the favourable developments since July.
- The Canadian economy is projected to contract by 2.4 per cent this year and to grow by 3.0 per cent in 2010 and 3.3 per cent in 2011.
- Inflation is expected to return to the 2 per cent target in the third quarter of 2011, one quarter later than was projected in July.
- The Bank maintained its policy rate at 1/4 per cent and reaffirmed its conditional commitment to hold its current policy rate until the end of the second quarter of 2010.
- As a consequence of conducting monetary policy at the effective lower bound, the Bank judges that the overall risks to its inflation projection are tilted slightly to the downside.

The Bank now expects that the output gap will be closed in the third quarter of 2011, one quarter later than it had projected in July. Correspondingly, inflation is also expected to return to the 2 per cent target in the third quarter of 2011, one quarter later than in July's projection.

The risks to the outlook remain elevated, although they have diminished somewhat since the July *Report*, with accumulating evidence of a recovery in the global and Canadian economies.

The main upside risks to inflation relate to the possibility of a stronger-than-anticipated recovery in the global economy. A stronger global recovery would be transmitted to Canada via trade, financial,

confidence, and commodity-price channels. There is also the risk that Canadian domestic demand could be more robust and have a more sustained momentum than projected.

On the downside, a stronger-than-assumed Canadian dollar, driven by global portfolio movements out of U.S.-dollar assets, could act as a significant further drag on growth and put additional downward pressure on inflation. Another important downside risk is that the global recovery could be even more protracted than projected if self-sustaining growth in private demand, which will be required for a solid recovery, takes longer than expected to materialize.

Projection for global economic growth

| | Share of real global GDP ^a (per cent) | Projected growth (per cent) ^b | | | |
|-------------------|--|--|--------------------|------------------|------------------|
| | | 2008 | 2009 | 2010 | 2011 |
| United States | 21 | 0.4 (1.1) | -2.5 (-2.4) | 1.8 (1.4) | 3.8 (3.4) |
| Euro area | 16 | 0.5 (0.6) | -3.9 (-4.4) | 0.9 (0.7) | 2.4 (2.4) |
| Japan | 7 | -0.7 (-0.7) | -5.7 (-6.0) | 1.7 (1.9) | 2.5 (2.8) |
| China | 11 | 9.1 (9.1) | 8.1 (7.8) | 8.9 (8.3) | 8.9 (9.6) |
| Rest of the world | 45 | 3.9 (3.9) | -2.1 (-2.1) | 3.3 (1.9) | 3.7 (3.5) |
| World | 100 | 2.9 (3.0) | -1.6 (-1.7) | 3.1 (2.3) | 4.0 (3.9) |

a. GDP shares are based on IMF estimates of the purchasing-power-parity (PPP) valuation of country GDPs for 2007.

Source: IMF, *WEO*, April 2009.

b. Numbers in parentheses are projections used for the July 2009 *Monetary Policy Report*.

Source: Bank of Canada

Summary of the base-case projection^a

| | 2008 | 2009 | | | | 2010 | | | | 2011 | | | |
|---|-------------|-------------|-------------|-------------|-------------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|
| | Q4 | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 |
| Real GDP (quarter-over-quarter percentage change) | -3.7 (-3.7) | -6.1 (-5.4) | -3.4 (-3.5) | 2.0 (1.3) | 3.3 (3.0) | 3.8 (4.0) | 3.8 (4.0) | 3.7 (3.8) | 3.5 (3.8) | 3.3 (3.8) | 3.3 (3.3) | 2.8 (2.8) | 2.5 (2.8) |
| Real GDP (year-over-year percentage change) | -1.0 (-1.0) | -2.3 (-2.1) | -3.2 (-3.1) | -2.8 (-2.9) | -1.1 (-1.2) | 1.4 (1.2) | 3.2 (3.1) | 3.6 (3.7) | 3.6 (3.9) | 3.5 (3.8) | 3.4 (3.7) | 3.2 (3.4) | 3.0 (3.2) |
| Core inflation (year-over-year percentage change) | 2.2 (2.2) | 2.0 (2.0) | 1.9 (1.9) | 1.7 (1.6) | 1.4 (1.4) | 1.4 (1.4) | 1.5 (1.6) | 1.5 (1.6) | 1.7 (1.7) | 1.8 (1.9) | 1.9 (2.0) | 2.0 (2.0) | 2.0 (2.0) |
| Total CPI (year-over-year percentage change) | 2.0 (2.0) | 1.2 (1.2) | 0.1 (0.1) | -0.9 (-0.7) | 1.0 (1.2) | 1.4 (1.4) | 1.4 (1.4) | 1.3 (1.3) | 1.6 (1.7) | 1.8 (1.8) | 1.9 (2.0) | 2.0 (2.0) | 2.0 (2.0) |
| WTI ^b (level) | 58 (58) | 43 (43) | 60 (60) | 68 (62) | 73 (64) | 75 (67) | 76 (68) | 77 (69) | 78 (70) | 79 (71) | 80 (72) | 80 (73) | 81 (74) |

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

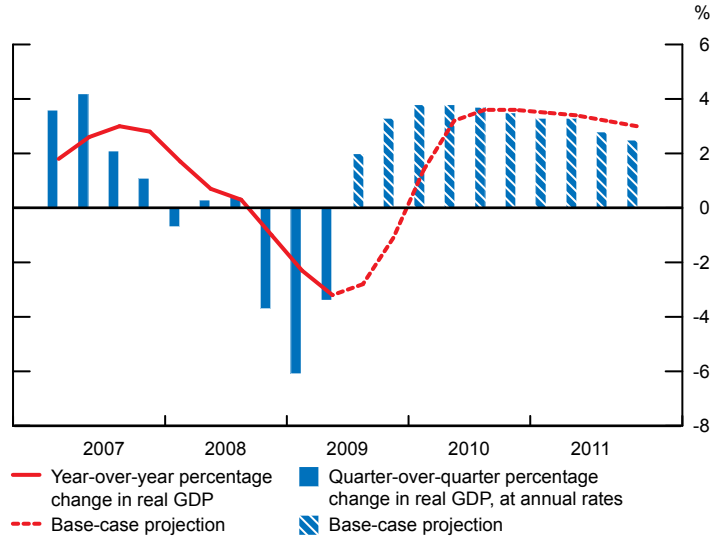
b. Assumptions for the price of West Texas Intermediate crude oil (US\$ per barrel), based on an average of futures contracts over the two weeks ending 16 October 2009.

Over the medium term, global macroeconomic imbalances continue to pose significant risks to the outlook.

While the underlying macroeconomic risks to the projection are roughly balanced, the Bank judges that, as a consequence of operating at the effective lower bound, the overall risks to its inflation projection are tilted slightly to the downside.

On 10 September and 20 October, the Bank reaffirmed its conditional commitment to maintain its target for the overnight rate at its current level of 1/4 per cent until the end of the second quarter of 2010 in order to achieve the inflation target. In its conduct of monetary policy at low interest rates, the Bank retains considerable flexibility, consistent with the framework outlined in the April Report.

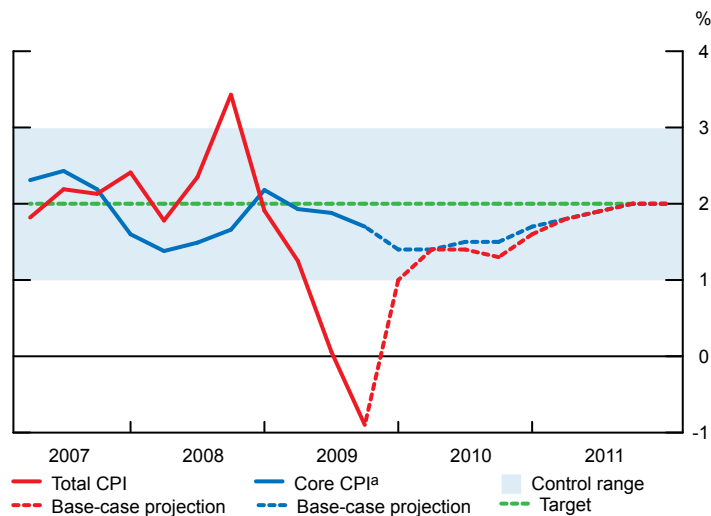
Real GDP growth is expected to rebound in the second half of 2009



Sources: Statistics Canada and Bank of Canada calculations

Total CPI and core inflation in Canada are projected to return to 2 per cent in the third quarter of 2011

Year-over-year percentage change, quarterly data



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