BANK OF CANADA
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Monetary Policy Report Summary

April 2011

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 8 April 2011.

Highlights

- The global economic recovery is becoming more firmly entrenched and is expected to continue at a steady pace.
- Recent economic activity in Canada has been stronger than anticipated, but largely consistent with the expected underlying dynamics. Aggregate demand is rebalancing toward business investment and net exports, and away from government and household expenditures.
- The Canadian economy is projected to expand by 2.9 per cent in 2011 and 2.6 per cent in 2012. Growth in 2013 is expected to equal that of potential output, at 2.1 per cent.
- The Canadian economy is expected to return to capacity and inflation to the 2 per cent target in the middle of 2012.
- On 12 April 2011, the Bank maintained the target for the overnight rate at 1 per cent.

As anticipated in January, the global economic recovery is becoming more firmly entrenched and is expected to continue at a steady pace. In the United States, growth is solidifying, although consolidation of household and ultimately government balance sheets will limit the pace of the expansion. European growth has strengthened, despite ongoing sovereign debt and banking challenges in the periphery. The disasters that struck Japan in March will severely affect its economic activity in the first half of this year and create short-term disruptions to supply chains in advanced economies. Robust demand from emerging-market economies is driving the underlying strength in commodity prices, which is being further reinforced by supply shocks arising from recent geopolitical events. These price increases, combined with persistent excess demand conditions in major emerging-market economies, are contributing to the emergence of broader global inflationary pressures. Despite the significant challenges that weigh on the global outlook, global financial conditions remain very stimulative and investors have become noticeably less risk averse.

Although recent economic activity in Canada has been stronger than the Bank had anticipated, the profile is largely consistent with the underlying dynamics outlined in January. Aggregate demand is rebalancing toward business investment and net exports, and away from government and household expenditures. As in January, the Bank expects business investment to continue to rise rapidly and the growth of consumer spending to evolve broadly in line with that of personal disposable income, although higher terms of trade and wealth are likely to support a slightly stronger profile for household expenditures than previously projected. In contrast, the improvement in net exports is expected to be further restrained by ongoing competitiveness challenges, which have been reinforced by the recent strength of the Canadian dollar.

Overall, the Bank projects that the economy will expand by 2.9 per cent in 2011 and 2.6 per cent in 2012. Growth in 2013 is expected to equal that of potential output, at 2.1 per cent. The Bank expects that the economy will return to capacity in the middle of 2012, two quarters earlier than had been projected in January.

While underlying inflation is subdued, a number of temporary factors will boost total CPI inflation to around 3 per cent in the second quarter of 2011 before total CPI inflation converges to the 2 per cent target by the middle of 2012. This short-term volatility reflects the impact of recent sharp increases in energy prices and the ongoing boost from changes in provincial indirect taxes. Core inflation has fallen further in recent months, in part due to temporary factors. It is expected to rise gradually to 2 per cent by the middle of 2012 as excess supply in the economy is slowly absorbed, labour compensation growth stays modest, productivity recovers and inflation expectations remain well-anchored.

The persistent strength of the Canadian dollar could create even greater headwinds for the Canadian economy, putting additional downward pressure on inflation through weaker-than-expected net exports and larger declines in import prices.

Projection for global economic growth

	Share of real global GDP[a] (per cent)	Projected growth (per cent)[b]			
		2010	2011	2012	2013
United States	20	2.9 *(2.9)*	3.0 *(3.3)*	3.2 *(3.2)*	3.3
Euro area	15	1.7 *(1.7)*	1.8 *(1.5)*	1.7 *(1.5)*	2.3
Japan[c]	6	4.0 *(4.3)*	0.8 *(1.4)*	2.6 *(2.1)*	2.5
China	13	10.3 *(10.4)*	9.3 *(9.3)*	8.6 *(8.8)*	8.1
Rest of the world	46	5.5 *(5.7)*	4.3 *(4.0)*	3.8 *(3.8)*	3.6
World	**100**	**4.9 *(5.0)***	**4.1 *(4.0)***	**3.9 *(3.9)***	**3.9**

a. GDP shares are based on IMF estimates of the purchasing-power-parity (PPP) valuation of country GDPs for 2009. Source: IMF, WEO, October 2010

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

c. Owing to historical revisions to the first three quarters of 2010, the growth rate of GDP in Japan for that year is lower than projected in the January *Report*.

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)	3.3 *(2.3)*	4.2 *(2.5)*	2.0 *(2.8)*	2.7 *(3.0)*	2.7 *(3.0)*	2.6 *(2.9)*	2.6 *(2.6)*	2.3 *(2.5)*	2.1 *(2.5)*	2.1	2.1	2.1	2.1
Real GDP (year-over-year percentage change)	3.2 *(2.8)*	2.9 *(2.0)*	2.8 *(2.2)*	3.1 *(2.6)*	2.9 *(2.8)*	2.5 *(2.9)*	2.7 *(2.9)*	2.6 *(2.7)*	2.4 *(2.6)*	2.3	2.1	2.1	2.1
Core inflation (year-over-year percentage change)	1.6 *(1.6)*	1.2 *(1.4)*	1.4 *(1.5)*	1.7 *(1.6)*	1.8 *(1.7)*	1.9 *(1.8)*	2.0 *(1.9)*	2.0 *(1.9)*	2.0 *(2.0)*	2.0	2.0	2.0	2.0
Total CPI (year-over-year percentage change)	2.3 *(2.3)*	2.4 *(2.2)*	2.7 *(2.3)*	2.5 *(1.9)*	2.5 *(2.0)*	2.2 *(1.8)*	2.0 *(1.9)*	2.0 *(1.9)*	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)	1.9 *(1.9)*	1.9 *(1.7)*	2.2 *(1.8)*	2.5 *(1.9)*	2.4 *(1.9)*	2.2 *(1.8)*	2.0 *(1.9)*	2.0 *(1.9)*	2.0 *(2.0)*	2.0	2.0	2.0	2.0
WTI[b] (level)	85 *(85)*	94 *(91)*	108 *(93)*	109 *(95)*	109 *(95)*	109 *(95)*	108 *(95)*	107 *(95)*	106 *(95)*	105	104	104	103

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

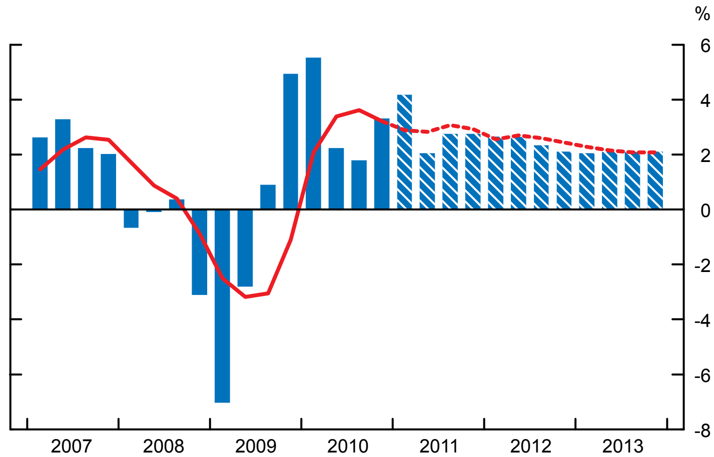
b. Assumptions for the price of West Texas Intermediate crude oil (US$ per barrel), based on an average of futures contracts over the two weeks ending 8 April 2011

Although the global economic recovery is expected to continue at a steady pace, global risks remain elevated. The two main upside risks to inflation in Canada relate to the possibility of higher-than-projected commodity prices and global inflation, and increased momentum in Canadian household spending. The two main downside risks to inflation relate to headwinds from the persistent strength in the Canadian dollar and the possibility that growth in household spending could be weaker than projected.

Overall, the Bank judges the risks to the inflation outlook in Canada are roughly balanced over the projection horizon.

Reflecting all of these factors, on 12 April 2011 the Bank decided to maintain the target for the overnight

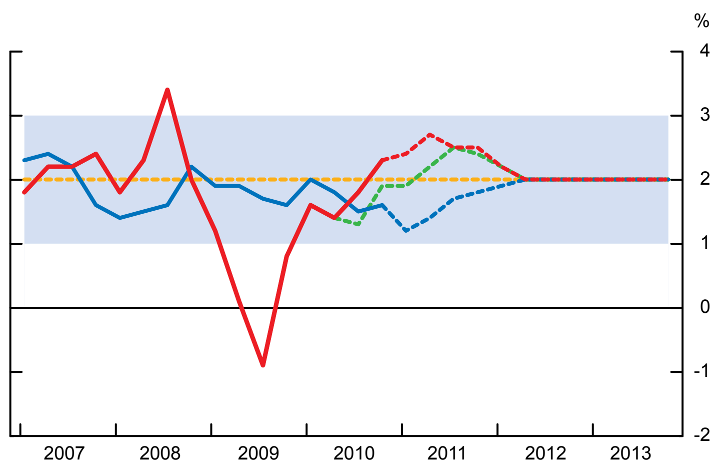
Real GDP is expected to grow at a rate consistent with the gradual absorption of excess supply



Sources: Statistics Canada and Bank of Canada projections

Total CPI and core inflation in Canada are projected to converge to 2 per cent by the middle of 2012

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 and projections rate at 1 per cent. The Bank Rate is correspondingly 1 1/4 per cent and the deposit rate is 3/4 per cent. This leaves considerable monetary stimulus in place, consistent with achieving the 2 per cent inflation target in an environment of material excess supply in Canada. Any further reduction in monetary policy stimulus would need to be carefully considered.

The Bank of Canada's *Monetary Policy Report* is published quarterly in January, April, July and October.

Print copies of the *Report* and the *Summary* may be obtained by contacting Publications Distribution, Communications Department, Bank of Canada, 234 Wellington St., Ottawa, Ontario, Canada K1A 0G9

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