BANK OF CANADA
BANQUE DU CANADA

Monetary Policy Report Summary

July 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 15 July 2011.

The global economic expansion is proceeding broadly as projected in April, with modest growth in major advanced economies and robust expansions in emerging economies. The U.S. economy has grown at a slower pace than expected and continues to be restrained by the consolidation of household balance sheets and slow growth in employment. While growth in core Europe has been stronger than expected, necessary fiscal austerity measures in a number of countries will restrain growth over the projection horizon. The Japanese economy has begun to recover from the disasters that struck in March, although the level of economic activity in that country will remain below previous expectations. In contrast, growth in emerging-market economies, particularly China, remains very strong. As a consequence, commodity prices are expected to remain at elevated levels, following recent declines. These high prices, combined with persistent excess demand in major emerging-market economies, are contributing to broader global inflationary pressures. Widespread concerns over sovereign debt have increased risk aversion and volatility in financial markets.

In Canada, the economic expansion is proceeding largely as projected, although the expected rotation of demand is somewhat slower than had been anticipated. Household spending remains solid and business investment robust. Net exports remain weak, reflecting modest U.S. demand and ongoing competitiveness challenges, particularly the persistent strength of the Canadian dollar. Despite increased global risk aversion, financial conditions in Canada remain very stimulative and private credit growth is strong.

Highlights

- Growth in major advanced economies is modest, while the robust expansions in emerging economies continue.
- In Canada, the economic expansion is proceeding largely as projected, although the expected rotation of demand is somewhat slower than had been anticipated.
- The Canadian economy is projected to expand by 2.8 per cent in 2011, 2.6 per cent in 2012 and 2.1 per cent in 2013, returning to capacity in the middle of 2012.
- Total CPI inflation is expected to return to the 2 per cent target by the middle of 2012.
- On 31 May and 19 July, the Bank maintained the target for the overnight rate at 1 per cent.

Following an anticipated slowdown in growth during the second quarter due to temporary supply-chain disruptions and the impact of higher energy prices on consumption, the Bank expects growth in Canada to re-accelerate in the second half of 2011. Over the projection horizon, business investment is expected to remain strong, household spending to grow more in line with disposable income and net exports to become more supportive of growth. Relative to the April projection, growth in household spending is

www.bankofcanada.ca

now projected to be slightly firmer, reflecting higher household income, and net exports to be slightly weaker, reflecting more subdued U.S. activity. Overall, the Bank projects the economy will expand by 2.8 per cent in 2011, 2.6 per cent in 2012 and 2.1 per cent in 2013, returning to capacity in the middle of 2012.

Total CPI inflation is expected to remain above 3 per cent in the near term, largely reflecting temporary factors such as significantly higher food and energy prices. Core inflation is slightly firmer than anticipated, owing to temporary factors and to more persistent strength in the prices of some services. Core inflation is now expected to remain around 2 per cent over the projection horizon. Total CPI inflation is expected to return to the 2 per cent target by the middle of 2012 as temporary factors unwind, excess supply in the economy is gradually absorbed, labour compensation growth stays modest, productivity recovers and inflation expectations remain well anchored.

The Bank's projection assumes that authorities are able to contain the ongoing European sovereign debt crisis, although there are clear risks around this outcome.

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)*	2.4 *(3.0)*	3.2 *(3.2)*	3.3 *(3.3)*
Euro area	15	1.7 *(1.7)*	2.0 *(1.8)*	1.6 *(1.7)*	1.9 *(2.3)*
Japan	6	4.0 *(4.0)*	-0.6 *(0.8)*	2.9 *(2.6)*	3.0 *(2.5)*
China	13	10.3 *(10.3)*	9.3 *(9.3)*	8.6 *(8.6)*	8.1 *(8.1)*
Rest of the world	46	5.5 *(5.5)*	4.2 *(4.3)*	3.8 *(3.8)*	3.6 *(3.6)*
World	**100**	**5.0** ***(4.9)***	**3.9** ***(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 2010. Source: IMF, WEO, April 2011

b. Numbers in parentheses are projections used for the April 2011 *Monetary Policy Report*.

Source: Bank of Canada

Summary of the base-case projection for Canada[a]

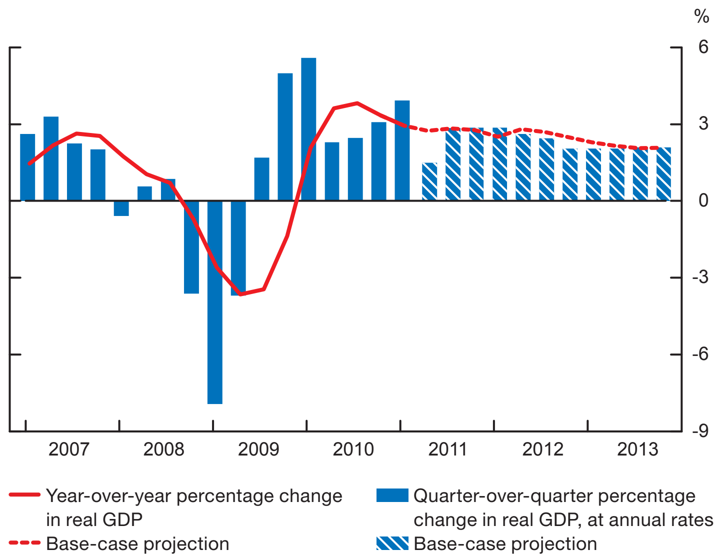
	2010	2011				2012				2013			
	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Real GDP (quarter-over-quarter percentage change at annual rates)	3.1 *(3.3)*	3.9 *(4.2)*	1.5 *(2.0)*	2.8 *(2.7)*	2.9 *(2.7)*	2.9 *(2.6)*	2.6 *(2.6)*	2.5 *(2.3)*	2.1 *(2.1)*	2.1 *(2.1)*	2.1 *(2.1)*	2.1 *(2.1)*	2.1 *(2.1)*
Real GDP (year-over-year percentage change)	3.3 *(3.2)*	2.9 *(2.9)*	2.7 *(2.8)*	2.8 *(3.1)*	2.8 *(2.9)*	2.5 *(2.5)*	2.8 *(2.7)*	2.7 *(2.6)*	2.5 *(2.4)*	2.3 *(2.3)*	2.1 *(2.1)*	2.1 *(2.1)*	2.1 *(2.1)*
Core inflation (year-over-year percentage change)	1.6 *(1.6)*	1.3 *(1.2)*	1.7 *(1.4)*	1.9 *(1.7)*	2.0 *(1.8)*	2.1 *(1.9)*	2.0 *(2.0)*	2.0 *(2.0)*	2.0 *(2.0)*	2.0 *(2.0)*	2.0 *(2.0)*	2.0 *(2.0)*	2.0 *(2.0)*
Total CPI (year-over-year percentage change)	2.3 *(2.3)*	2.6 *(2.4)*	3.4 *(2.7)*	2.8 *(2.5)*	2.6 *(2.5)*	2.3 *(2.2)*	1.9 *(2.0)*	2.0 *(2.0)*	2.0 *(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)	1.9 *(1.9)*	2.1 *(1.9)*	2.9 *(2.2)*	2.8 *(2.5)*	2.5 *(2.4)*	2.3 *(2.2)*	1.9 *(2.0)*	2.0 *(2.0)*	2.0 *(2.0)*	2.0 *(2.0)*	2.0 *(2.0)*	2.0 *(2.0)*	2.0 *(2.0)*
WTI[b] (level)	85 *(85)*	94 *(94)*	103 *(108)*	97 *(109)*	98 *(109)*	100 *(109)*	101 *(108)*	102 *(107)*	102 *(106)*	103 *(105)*	103 *(104)*	103 *(104)*	103 *(103)*

a. Figures in parentheses are from the base-case projection in the April 2011 *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 15 July 2011

More broadly, there are a number of risks to the outlook for inflation in Canada. The three main upside risks to inflation in Canada relate to the possibility of higher-than-projected commodity prices and global inflation, stronger momentum in Canadian household spending, and the possibility that there is less excess capacity in the Canadian economy.

The three main downside risks to inflation in Canada relate to sovereign debt concerns in Europe, headwinds from the persistent strength of the Canadian dollar, and the possibility that growth in Canadian household spending could be weaker than projected.

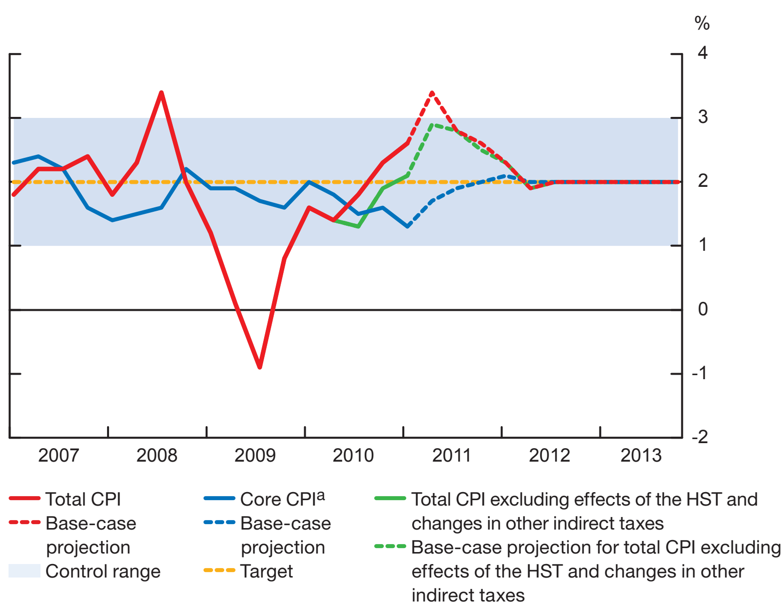
Real GDP is expected to grow at a rate consistent with the gradual absorption of excess supply



Sources: Statistics Canada and Bank of Canada projections

Total CPI inflation in Canada is 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

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

Reflecting all of these factors, on 19 July, the Bank maintained the target for the overnight rate at 1 per cent. To the extent that the expansion continues and the current material excess supply in the economy is gradually absorbed, some of the considerable monetary policy stimulus currently in place will be withdrawn, consistent with achieving the 2 per cent inflation target. Such reduction would need to be carefully considered.

Bank of Canada Publications

Unless noted otherwise, all publications are available in print and on the Bank's website: **www.bankofcanada.ca**

Monetary Policy Report (January, April, July and October)

Financial System Review (June/December)

Bank of Canada Review (quarterly; see website for subscription information)

Business Outlook Survey (January, April, July and October)

Senior Loan Officer Survey (January, April, July and October)*

Speeches and Statements by the Governor*

Bank of Canada Banking and Financial Statistics (monthly)*

Weekly Financial Statistics (published each Friday)*

Renewal of the Inflation-Control Target: Background Information

Annual Report

* Available only on the Bank's website

A History of the Canadian Dollar
James Powell (available at Can$8 plus applicable taxes)

Conference Proceedings
Conference volumes published up to and including April 2005 are available in print and on the Bank's website. Print copies can be purchased for Can$15 plus applicable taxes. Papers and proceedings from Bank of Canada conferences, seminars and workshops held after April 2005 are now published exclusively on the Bank's website.

Technical Reports, Working Papers and Discussion Papers*
Technical Reports, Working Papers and Discussion Papers are usually published in the original language only, with an abstract in both official languages. Discussion Papers deal with finished work on technical issues related to the functions and policy making of the Bank. They are of interest to specialists and other central bankers.

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

Telephone: **1 800 303-1282**; email: **publications@bankofcanada.ca**; website: **www.bankofcanada.ca**

ISSN 1924-1089 (Print) ISSN 1925-3168 (Online)