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Canadian Mortgage News - National Archive 2010

Bank of Canada maintains overnight rate target at 1 per cent

OTTAWA, Ontario, October 19, 2010 — The Bank of Canada today announced that it is maintaining its target for the overnight rate at 1 per cent. The Bank Rate is correspondingly 1 1/4 per cent and the deposit rate is 3/4 per cent.

The global economic recovery is entering a new phase. In advanced economies, temporary factors supporting growth in 2010 - such as the inventory cycle and pent-up demand - have largely run their course and fiscal stimulus will shift to fiscal consolidation over the projection horizon. While the Bank expects that private demand in advanced economies will become sufficiently entrenched to sustain the recovery, the combination of difficult labour market dynamics and ongoing deleveraging in many advanced economies is expected to moderate the pace of growth relative to prior expectations. These factors will contribute to a weaker-than-projected recovery in the United States in particular. Growth in emerging-market economies is expected to ease to a more sustainable pace as fiscal and monetary policies are tightened. Heightened tensions in currency markets and related risks associated with global imbalances could result in a more protracted and difficult global recovery.

The economic outlook for Canada has changed. The Bank expects the economic recovery to be more gradual than it had projected in its July *Monetary Policy Report*, with growth of 3.0 per cent in 2010, 2.3 per cent in 2011, and 2.6 per cent in 2012. This more modest growth profile reflects a more gradual global recovery and a more subdued profile for household spending. With housing activity declining markedly as anticipated and household debt considerations becoming more important, the Bank expects household expenditures to decelerate to a pace closer to the rate of income growth over the projection horizon. Overall, the composition of demand in Canada is expected to shift away from government and household expenditures towards business investment and net exports. The strength of net exports will be sensitive to currency movements, the expected recovery in productivity growth, and the prospects for external demand.

Inflation in Canada has been slightly below the Bank’s July projection. The recent moderation in core inflation is consistent with the persistence of significant excess supply and a deceleration in the growth of unit labour costs. The Bank judges that the output gap is slightly larger and that the economy will return to full capacity by the end of 2012 rather than the beginning of that year, as had been anticipated in July. The inflation outlook has been revised down and both total CPI and core inflation are now expected to converge to 2 per cent by the end of 2012, as excess supply in the economy is gradually absorbed and inflation expectations remain well-anchored.

Reflecting all of these factors, the Bank has decided to maintain the target for the overnight rate at 1 per cent. This leaves considerable monetary stimulus in place, consistent with achieving the 2 per cent inflation target in an environment of significant excess supply in Canada.

At this time of transition in the global recovery, with a weaker U.S. outlook, constraints beginning to moderate growth in emerging-market economies, and domestic considerations that are expected to slow consumption and housing activity in Canada, any further reduction in monetary policy stimulus would need to be carefully considered.

Information note:

A full update of the Bank's outlook for the economy and inflation, including risks to the projection, will be published in the MPR on 20 October 2010. The next scheduled date for announcing the overnight rate target is 7 December 2010.