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Bank of Canada releases Monetary Policy Report

OTTAWA, Ontario, October 23, 2008 — The Bank of Canada today released its October *Monetary Policy Report*, which discusses current economic and financial trends in the context of Canada's inflation-control strategy.

In the *Report*, the Bank noted that three major interrelated global developments are having a profound impact on the Canadian economy and making the outlook for growth and inflation more uncertain than it was at the time of the July *Monetary Policy Report Update*. First, the intensification of the global financial crisis has led to severe strains in financial markets. The associated need for the global banking sector to continue to reduce leverage will restrain growth for some time. Second, the global economy appears to be heading into a mild recession, led by a U.S. economy that is already in recession. Third, there have been sharp declines in many commodity prices.

Consistent with the G7 Plan of Action, major economies have announced extraordinary measures to stabilize their financial systems. These initiatives will be pivotal to the resumption of the flow of credit to support global economic growth. Canada's economy and strong financial system will benefit directly from these actions.

The weaker outlook for global demand will increase the drag on the Canadian economy coming from exports. Lower commodity prices will also dampen the outlook, working through a deterioration in Canada's terms of trade to moderate domestic demand growth. The marked tightening in Canadian credit conditions in recent weeks will restrain business and housing investment.

The Bank expects growth to be sluggish through the first quarter of next year, then to pick up over the rest of 2009 and to accelerate to above-potential growth in 2010 supported by improving credit conditions, the lagged effects of monetary policy actions, and stronger global growth. The recent sizable depreciation of the Canadian dollar will also provide an important offset to the effects of weaker global demand and lower commodity prices. Overall, the Bank projects average annual growth in real GDP of 0.6 per cent in both 2008 and 2009, and 3.4 per cent in 2010.

With excess supply projected to build throughout 2009, and with lower assumed energy prices, inflationary pressures will ease significantly relative to the projection in the July *Monetary Policy Report Update*. Core inflation is now projected to remain below 2 per cent until the end of 2010. Total CPI inflation should peak during the third quarter of 2008, fall below 1 per cent in mid-2009, and then return to the 2 per cent target by the end of 2010.

On 21 October, the Bank of Canada lowered its policy interest rate by 25 basis points. That decision followed a 50 basis point cut on 8 October taken in concert with other major central banks. Together, these moves bring the cumulative reduction in the Bank's target for the overnight rate to 75 basis points since the Bank's previous fixed announcement date on 3 September. These actions provide timely and significant support to the Canadian economy. The cumulative reduction in the Bank's policy rate since the beginning of December 2007 is now 225 basis points.

In line with the new outlook, some further monetary stimulus will likely be required to achieve the 2 per cent inflation target over the medium term. The evolution of the financial crisis, its impact on the global economy, and the timing of

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the effects of the various extraordinary measures being taken to address it pose significant risks to the inflation projection on both the upside and the downside