

# Essentials of the Monetary Policy

November 8, 2007



**BANK OF ENGLAND**



**EUROPEAN CENTRAL BANK**

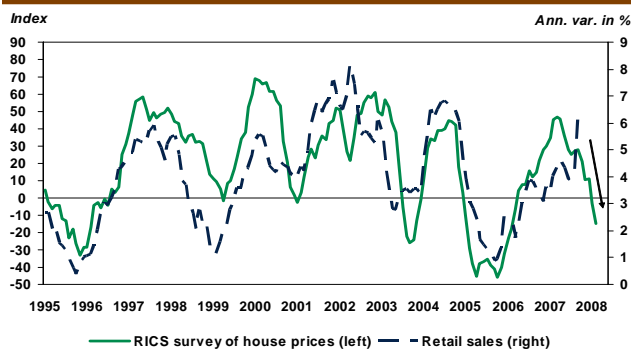
**The uncertainty continues: The status quo is still the most valid option**

## BANK OF ENGLAND (BoE)

To no one's surprise, the BoE kept its key rate at 5.75% this morning. Anything else would have been a surprise. The British economy is still showing surprising resilience. Real GDP posted an annualized gain of 3.2% for Q3, making that the eighth straight quarter above the potential growth rate. However, cresting by home price increases signals that a slowdown by consumer spending is to be expected. Retail sales were surprisingly lively in September, but the recent divergence between the volume of sales – powered by substantial price cuts – and home prices does not seem sustainable.

**Implications:** It is still too early to quantify the potential impact of tightened credit conditions on the British economy, but the BoE's bias is still to the downside. Note that one member (8 vs. 1) voted in favour of an immediate rate cut in October. Inflation has retreated more quickly than forecast, giving the BoE more leeway if the need to kickstart the economy emerges. We will find out more about inflation when the BoE's quarterly report is released on November 14.

Britain's recent retail sales growth seems unsustainable



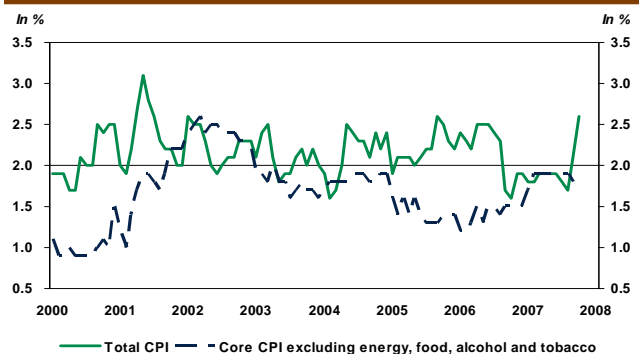
Sources: Royal Institution of Chartered Surveyors, Office of National Statistics and Desjardins, Economic Studies

## EUROPEAN CENTRAL BANK (ECB)

This morning, the ECB opted for the status quo, keeping its key rate at 4.0% at its November meeting. The ECB is keeping the door open for further monetary firming by stating that the risks associated with inflation are still tilted to the upside. The ECB is concerned by sharp credit growth, high oil prices and increases in food prices. However, more than ever, the bank seems to be depending on how economic statistics evolve. It says that the revaluation of risk on the financial markets has introduced some uncertainty that requires that all variables be examined closely before the monetary policy is modified. Therefore, although inflation jumped to 2.6% in September, the ECB has opted for caution.

**Implications:** The jump in annual inflation is a concern, but the ECB is aware that it is primarily a reflection of base effects associated with low energy prices this time last year. As a result, the inflation underlying the Euroland economy is contained. In our view, with the expected slower growth in the euro zone and a euro at US\$1.45, interest rates will top out at 4.0%.

Total inflation has jumped, reflecting the surge by energy prices, but core inflation is steady



Sources: Datastream and Desjardins, Economic Studies

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**EXCERPT FROM THE EUROPEAN CENTRAL BANK PRESS RELEASE  
NOVEMBER 8, 2007**


[...] On the basis of our regular economic and monetary analyses, we decided at today's meeting to leave the key ECB interest rates unchanged. The information that has become available since our previous meeting fully confirms that the outlook for price stability over the medium term is subject to upside risks. Against this background, and with money and credit growth vigorous in the euro area, our monetary policy stands ready to counter upside risks to price stability, as required by our mandate. The economic fundamentals of the euro area remain sound and support a favourable medium-term outlook for economic activity. However, the ongoing reappraisal of risk in financial markets has led to continued uncertainty. This warrants a thorough examination of additional information before drawing further conclusions for monetary policy in the context of our medium term-oriented monetary policy strategy focused on maintaining price stability. Accordingly, the Governing Council will monitor very closely all developments. By acting in a firm and timely manner on the basis of our assessment, we will ensure that risks to price stability over the medium term do not materialise and that medium and long-term inflation expectations remain firmly anchored in line with price stability, which is all the more important at times of financial market volatility and increased uncertainty. This will favour an environment conducive to sustained economic growth, well-functioning markets and job creation. As regards the financial markets, we will continue to pay great attention to developments over the period to come. [...]

**Table 1  
Schedule and key rates**

Date	Central Bank	Decision	Rate
<b>September 2007</b>			
4	Reserve Bank of Australia	s.q.	6.50
5	Bank of Brazil	-25 b.p.	11.25
5	Bank of Canada	s.q.	4.50
6	European Central Bank	s.q.	4.00
6	Bank of England	s.q.	5.75
7	Bank of Sweden	+25 b.p.	3.75
12	Reserve Bank of New Zealand	s.q.	8.25
13	Swiss National Bank	+25 b.p.	2.75
18	U.S. Federal Reserve	-50 b.p.	4.75
19	Bank of Japan	s.q.	3.00
21	Bank of Mexico	s.q.	7.25
21	Bank of Norway	+25 b.p.	5.00
<b>October 2007</b>			
2	Reserve Bank of Australia	s.q.	6.50
4	European Central Bank	s.q.	4.00
4	Bank of England	s.q.	5.75
11	Bank of Japan	s.q.	0.50
16	Bank of Canada	s.q.	4.50
17	Bank of Brazil	s.q.	11.25
24	Reserve Bank of New Zealand	s.q.	8.25
30	Bank of Mexico	+25 b.p.	7.50
30	Bank of Sweden	+25 b.p.	4.00
31	Bank of Japan	s.q.	0.50
30	Bank of Norway	s.q.	5.00
31	U.S. Federal Reserve	-25 b.p.	4.50
<b>November 2007</b>			
6	Reserve Bank of Australia	+25 b.p.	6.75
8	European Central Bank	s.q.	4.00
8	Bank of England	s.q.	5.75

s.q.: status quo; b.p. : basis points  
Source: Desjardins, Economic Studies

**Table 2  
Coming soon...**

Date	Central Bank
<b>November 2007</b>	
12	Bank of Japan
23	Bank of Mexico
<b>December 2007</b>	
4	Reserve Bank of Australia
4	Bank of Canada
4 - 5	Bank of Brazil
6	European Central Bank
6	Bank of England
6	Reserve Bank of New Zealand
7	Bank of Mexico
11	U.S. Federal Reserve
12	Bank of Norway
13	Swiss National Bank
18	Bank of Sweden
19 - 20	Bank of Japan
<b>January 2008</b>	
9 - 10	Bank of England
10	European Central Bank
18	Bank of Mexico
21 - 22	Bank of Japan
22	Bank of Canada
23	Bank of Norway
24	Reserve Bank of New Zealand
29 - 30	U.S. Federal Reserve
<b>February 2008</b>	
5	Reserve Bank of Australia
6 - 7	Bank of England
7	European Central Bank
12	Bank of Sweden
14 - 15	Bank of Japan

Source: Desjardins, Economic Studies