



## BANK OF CANADA

### Dodge bows out with one last decrease

#### ACCORDING TO THE BANK OF CANADA (BoC)

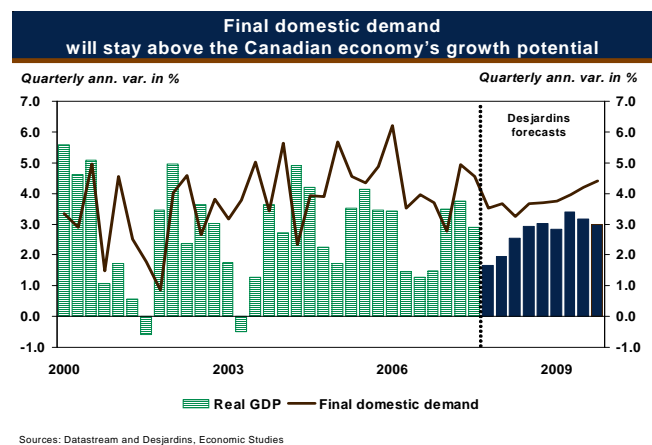
- The target for the overnight rate comes down 25 basis points, from 4.25% to 4.00%.
- The troubles afflicting global financial markets have deteriorated recently and should persist longer than forecast. Credit conditions have also tightened.
- The economy is still operating above production capacity. The impacts of the deterioration in the U.S. economic outlook will help intensify downside pressure on export growth. However, domestic demand should remain strong.
- Inflation is below the projections in October's *Report*, primarily due to increased competitive pressures in the retail sector stemming from the level of the Canadian dollar. Both core and total CPI inflation should fall below 1.5% by mid-2008.
- The risks to the Bank's inflation projection are roughly balanced. Further monetary stimulus will likely be needed in the near future.

#### COMMENTS

Given the risks of a recession in the United States, the global stock market correction, widening interest rate spreads and tightening credit conditions, there was no doubt that monetary easing would continue in Canada. The BoC thus opted to lower its key rate by 25 basis points to 4.0%.

The surprise announcement of a major cut (75 basis points) to federal funds by the U.S. Federal Reserve (Fed) a little earlier this morning could have encouraged the BoC to be more aggressive (U.S. key rates are now lower than Canadian rates). In particular, given that the U.S. housing sector's pullback is deeper and more prolonged than forecast, the outlook for the U.S. economy is now much grimmer. However, it is likely that the Fed's decision was made behind closed doors, and without the knowledge of Canada's monetary authorities. What's more, our economy's relatively solid performance made the BoC act prudently. Note that retail sales jumped 0.7% in November after a gain that was

revised upward to 0.3% for October, and the BoC expects domestic demand to remain robust in the coming quarters, despite tightening credit conditions.



Consequently, with an economy that is operating above production capacity, tight labour market conditions and rising wages, the BoC will have to remain vigilant about inflation. For now, intensifying competitive pressure stemming from the loonie's vitality is giving the BoC a lot of leeway in conducting its monetary policy.

**Implications:** With a strong likelihood of a further 50 basis point cut to federal funds at the Fed meeting next week, we now anticipate at least two further rate cuts in Canada, in March and April. This would take the target for the overnight rate to 3.50% in Canada.

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**NOTE TO READERS:** The letters **k**, **M** and **B** are used in texts and tables to refer to thousands, millions and billions respectively.

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**EXCERPT FROM THE BANK OF CANADA PRESS RELEASE  
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[...] Despite some slowing in growth in the fourth quarter, the Canadian economy continues to operate above its production capacity. Both core and total CPI inflation have been lower than projected in the *MPR*, largely reflecting a price-level adjustment related to increased competitive pressures in the retail sector stemming from the level of the Canadian dollar.

Financial market conditions have deteriorated since October, leading to a tightening of credit conditions in industrial countries. Given this, and a deeper, more prolonged decline in the U.S. residential housing sector, the 2008 outlook for the U.S. economy is now significantly weaker than at the time of the October *MPR*.

[...] the effects of the weaker U.S. economic outlook will lead to additional downward pressure on export growth. However, despite tighter credit conditions, domestic demand in Canada is projected to remain strong. [...] the Bank now projects weaker growth in 2008 than was expected in October, with the economy moving into modest excess supply in the second quarter of this year. [...] The inflation projection has also been revised down since October, especially for 2008, primarily reflecting the price-level adjustment noted above and the recent one-percentage-point cut in the GST. Both core and total CPI inflation should fall below 1 1/2 per cent by the middle of this year [...] On the whole, the Bank judges that the risks to this inflation projection are roughly balanced.

In line with this outlook, the Bank has decided to lower the target for the overnight rate and further monetary stimulus is likely to be required in the near term to keep aggregate supply and demand in balance and to return inflation to target over the medium term.

**Table 1  
Schedule and key rates**

Date	Central Bank	Decision	Rate
<b>October 2007</b>			
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
8	Bank of Japan	s.q.	0.50
23	Bank of Mexico	s.q.	7.50
<b>December 2007</b>			
4	Reserve Bank of Australia	s.q.	6.75
4	Bank of Canada	-25 b.p.	4.25
5	Reserve Bank of New Zealand	s.q.	8.25
5	Bank of Brazil	s.q.	11.25
6	European Central Bank	s.q.	4.00
6	Bank of England	-25 b.p.	5.50
7	Bank of Mexico	s.q.	7.50
11	U.S. Federal Reserve	-25 b.p.	4.25
<b>January 2008</b>			
10	European Central Bank	s.q.	4.00
10	Bank of England	s.q.	5.50
18	Bank of Mexico	s.q.	7.50
21	Bank of Japan	s.q.	0.50
22	U.S. Federal Reserve	-75 b.p.	3.50
22	Bank of Canada	-25 b.p.	4.00

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

**Table 2  
Coming soon**

Date	Central Bank
<b>January 2008</b>	
23	Bank of Norway
23	Bank of Brazil
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
15	Bank of Mexico
<b>March 2008</b>	
4	Reserve Bank of Australia
4	Bank of Canada
5 - 6	Bank of England
6	European Central Bank
6	Reserve Bank of New Zealand
6 - 7	Bank of Japan
13	Bank of Norway
13	Swiss National Bank
14	Bank of Mexico
18	U.S. Federal Reserve
<b>April 2008</b>	
1	Reserve Bank of Australia
8 - 9	Bank of Japan
9 - 10	Bank of England
10	European Central Bank
18	Bank of Mexico
22	Bank of Sweden
22	Bank of Canada

Source: Desjardins, Economic Studies