



BANK OF CANADA

Monetary easing comes to an early halt in Canada

ACCORDING TO THE BANK OF CANADA (BoC)

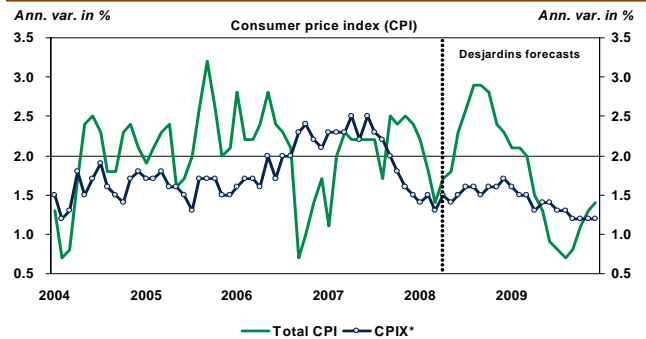
- The target for the overnight rate remains at 3.00%.
- The balance of risks to the Bank's April projection for inflation in Canada has shifted slightly to the upside. If current levels of energy prices persist, total CPI inflation will rise above 3% later this year. However, with the Canadian economy operating in excess supply, core inflation is expected to remain below 2% through 2009.
- The risk remains that potential growth will be weaker than assumed.
- With the decline in first-quarter GDP, the Canadian economy is judged to have moved into excess supply, which is expected to increase this year.
- Against this backdrop, the BoC now judges that the current stance of monetary policy is appropriately accommodative to bring aggregate demand and supply into balance and to achieve the 2% inflation target.

COMMENTS

In a broadly unexpected move, the BoC kept its key rate at 3.0% this morning. After two consecutive 50 basis point cuts, in March and April, we were expecting the Bank to slow the pace of monetary policy easing in Canada to 25 basis points, and shift the bias to neutral.

Another rate cut seemed essential. Following the first-quarter contraction in economic activity, there is nothing to show that economic growth will bounce back to any extent this spring. In particular, April's results for international merchandise trade show that Canada's foreign trade sector is still vulnerable to the U.S. economic slowdown and the strong loonie. And, although financial tensions have largely dissipated since mid-March and the risks of a major deterioration in the economic and financial situation are now gone, the context is still very uncertain, particularly with respect to how commercial banks' tightening of credit conditions will impact consumer spending.

Underlying inflation is contained, but elevated oil prices appear to worry the BoC



* Index that excludes the eight most volatile components and the effect of changes to indirect taxes.
Sources: Statistics Canada and Desjardins, Economic Studies

The recent turn taken by inflation, with ongoing high prices for oil and some foods, probably prodded the BoC to be cautious. However, the Bank says that the Canadian economy's excess capacity will keep underlying inflation below 2.0% through 2009, which is in line with our estimates.

With the Federal Reserve clearly indicating that it will stay on the sidelines for the next few months, a 25 basis point cut in Canada would have made it possible to close the spread between Canadian and American key rates to 75 basis points. The outcome would have been to rein in upward pressure on the loonie, one of the main reasons behind the current economic slowdown.

Implications: This morning's decision to stay with the status quo may conceal more concern about inflation than the BoC is showing. In our opinion, however, it will take more for the BoC to fall into step with the world's other central banks, and signal the possibility of interest rate increases. The most likely avenue is an extended status quo.

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[...] Since the April *Monetary Policy Report (MPR)*, economic developments have been broadly in line with expectations. However, the balance of risks to the Bank's April projection for inflation in Canada has shifted slightly to the upside. Although the composition of U.S. growth has not been favourable for demand for Canadian goods and services, overall, global growth has been stronger and commodity prices have been sharply higher than expected. At the same time, many of the downside risks to inflation identified in the April *MPR* have eased, while the evolution of credit conditions has been in line with expectations. The risk remains that potential growth will be weaker than assumed.

With the decline in first-quarter GDP, the Canadian economy is judged to have moved into excess supply, which is expected to increase this year. Consistent with the April *MPR*, the Bank continues to project that economic growth will pick up this year and accelerate in 2009, owing in part to a firming of U.S. demand and accommodative monetary policy in Canada.

If current levels of energy prices persist, total CPI inflation will rise above 3 per cent later this year. However, with the Canadian economy operating in excess supply, core inflation is expected to remain below 2 per cent through 2009. Both total and core inflation should converge on 2 per cent in 2010 as the economy returns to balance.

Against this backdrop, the Bank now judges that the current stance of monetary policy is appropriately accommodative to bring aggregate demand and supply into balance and to achieve the 2 per cent inflation target. There continue to be important downside and upside risks to inflation in Canada, which the Bank will monitor closely.

**Table 1
Schedule and key rates**

Date	Central Bank	Decision	Rate
March 2008			
14	Bank of Mexico	s.q.	7.50
18	U.S. Federal Reserve	-75 b.p.	2.25
10	Reserve Bank of Australia	s.q.	7.25
April 2008			
8	Bank of Japan	s.q.	0.50
10	Bank of England	-25 b.p.	5.00
10	European Central Bank	s.q.	4.00
16	Bank of Brazil	+50 b.p.	11.75
18	Bank of Mexico	s.q.	7.50
22	Bank of Canada	-50 b.p.	3.00
23	Bank of Norway	+25 b.p.	5.50
23	Reserve Bank of New Zealand	s.q.	8.25
23	Bank of Sweden	s.q.	4.25
29	Bank of Japan	s.q.	0.50
30	U.S. Federal Reserve	-25 b.p.	2.00
May 2008			
6	Reserve Bank of Australia	s.q.	7.25
8	Bank of England	s.q.	5.00
8	European Central Bank	s.q.	4.00
16	Bank of Mexico	s.q.	7.50
19	Bank of Japan	s.q.	0.50
28	Bank of Norway	s.q.	5.50
June 2008			
3	Reserve Bank of Australia	s.q.	7.25
4	Reserve Bank of New Zealand	s.q.	8.25
4	Bank of Brazil	+50 b.p.	12.25
5	Bank of England	s.q.	5.00
5	European Central Bank	s.q.	4.00
10	Bank of Canada	s.q.	3.00

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

**Table 2
Coming soon**

Date	Central Bank
June 2008	
12	Bank of Japan
19	Swiss National Bank
20	Bank of Mexico
25	Bank of Norway
25	U.S. Federal Reserve
July 2008	
1	Reserve Bank of Australia
3	European Central Bank
3	Bank of Sweden
10	Bank of England
14	Bank of Japan
15	Bank of Canada
18	Bank of Mexico
23	Reserve Bank of New Zealand
23	Bank of Brazil
August 2008	
5	Reserve Bank of Australia
5	U.S. Federal Reserve
7	Bank of England
13	Bank of Norway
15	Bank of Mexico
18	Bank of Japan
September 2008	
2	Reserve Bank of Australia
3	Bank of Canada
4	Bank of England
4	European Central Bank
10	Reserve Bank of New Zealand
10	Bank of Brazil

Source: Desjardins, Economic Studies