

July 3, 2008



## EUROPEAN CENTRAL BANK

### President Jean-Claude Trichet closes the door on the need to raise interest rates further in the near future

#### ACCORDING TO THE EUROPEAN CENTRAL BANK (ECB)

- The key ECB interest rates was increased by 25 basis points, to 4.25%.
- HICP inflation rates have continued to rise significantly since the autumn of last year and they are expected to remain well above the level consistent with price stability for a more protracted period than previously thought.
- Risks to price stability at the policy-relevant medium-term horizon remain clearly on the upside and have increased further over the past few months. These risks include notably the possibility of further increases in energy and food prices.
- The uncertainty surrounding this outlook for economic activity remains high, owing not least to the very high levels of commodity prices, and downside risks prevail.
- The monetary policy stance will contribute to achieving our objective.

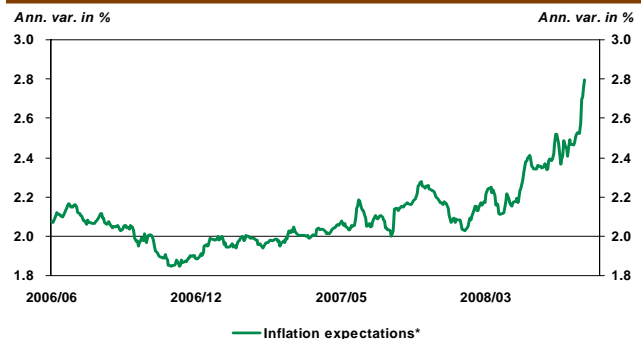
#### COMMENTS

As forecast, the ECB raised its key rate to 4.25% this morning. Anything else would have been a surprise as, in June, President Trichet had announced that a rate hike was very likely in July. With inflation estimated to be 4% in June, two percentage points above the ECB's target, the Bank was certainly not going to waste the opportunity to ensure its credibility as a defender of price stability.

The 25 basis point hike ordered in July will not have much impact on total inflation, which stems mainly from the increase in energy prices set by world markets. However, because of ongoing high oil prices, the deterioration in the inflation outlook and increase in inflation expectations, the ECB is concerned about second-round effects associated with wage and price setting.

July's increase should not be one of a series of interest rate increases. According to the ECB, interest rates are appropriate, and the fact that the words "heightened

#### Long term inflation expectations have risen sharply in the euro zone



\* Derived from the five-year French government inflation-protected bonds.  
Sources: Bloomberg and Desjardins, Economic Studies

alertness" have been dropped from the statement goes some ways toward indicating that the ECB would like to keep its rates steady.

**Implications:** The economic situation in PIGS (Portugal, Italy, Greece and Spain) is already fragile, and higher rates would only increase the likelihood of a generalized euro zone slowdown. That said, although we expect oil prices to correct, high inflation should keep the ECB from beginning a monetary easing cycle before 2009.

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**EXCERPT FROM THE EUROPEAN CENTRAL BANK PRESS RELEASE  
JULY 3, 2008**


[...] On the basis of our regular economic and monetary analyses, we decided at today's meeting to increase the key ECB interest rates by 25 basis points. This decision was taken to prevent broadly based second-round effects and to counteract the increasing upside risks to price stability over the medium term. HICP inflation rates have continued to rise significantly since the autumn of last year. They are expected to remain well above the level consistent with price stability for a more protracted period than previously thought. Moreover, continued very vigorous money and credit growth and the absence thus far of significant constraints on bank loan supply in a context of ongoing financial market tensions confirm our assessment of upside risks to price stability over the medium term. At the same time, while the latest data confirm the expected weakening of real GDP growth in mid-2008 after exceptionally strong growth in the first quarter, the economic fundamentals of the euro area are sound. Against this background and in full accordance with our mandate, we emphasise that maintaining price stability in the medium term is our primary objective and that it is our strong determination to keep medium and long-term inflation expectations firmly anchored in line with price stability. This will preserve purchasing power in the medium term and continue to support sustainable growth and employment in the euro area. On the basis of our current assessment, the monetary policy stance following today's decision will contribute to achieving our objective. We will continue to monitor very closely all developments over the period ahead. [...]

**Table 1  
Schedule and key rates**

Date	Central Bank	Decision	Rate
<b>April 2008</b>			
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	Federal Reserve	-25 b.p.	2.00
<b>May 2008</b>			
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
<b>June 2008</b>			
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
12	Bank of Japan	s.q.	0.50
19	Swiss National Bank	s.q.	2.75
20	Bank of Mexico	+25 b.p.	7.75
25	Bank of Norway	+25 b.p.	5.75
25	Federal Reserve	s.q.	2.00
<b>July 2008</b>			
1	Reserve Bank of Australia	s.q.	7.25
3	Bank of Sweden	+25 b.p.	4.50
3	European Central Bank	+25 b.p.	4.25

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

**Table 2  
Coming soon**

Date	Central Bank
<b>July 2008</b>	
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
<b>August 2008</b>	
5	Reserve Bank of Australia
5	Federal Reserve
7	Bank of England
13	Bank of Norway
15	Bank of Mexico
18	Bank of Japan
<b>September 2008</b>	
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
16	Bank of Japan
16	Federal Reserve
18	Swiss National Bank
19	Bank of Mexico
24	Bank of Norway
<b>October 2008</b>	
2	European Central Bank
6	Bank of Japan
7	Reserve Bank of Australia

Source: Desjardins, Economic Studies