Essentials of the Monetary Policy

Desjardins Economic Studies

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# BANK OF ENGLAND

# EUROPEAN CENTRAL BANK

## In Europe, inflation remains the main concern

### BANK OF ENGLAND (BoE)

Once again, the BoE opted to keep its key rate at 5.00% this morning. The *Inflation Report* released last month confirms the impasse that BoE leaders are dealing with. On one hand, inflation jumped to 4.4% in July and could soon reach a peak in the neighbourhood of 5%. On the other, Britain's economy stagnated in the second quarter and a recession appears to be almost inevitable. If it continues, the correction of energy prices should, however, bring inflation down more quickly than forecast and open the door for new rate cuts.

**Implications:** We will have to wait for the minutes of this morning's meeting to be published on September 17 to find out whether inflation pressures have moderated enough for the BoE to start easing its monetary policy in the near future. Contrary to the pullback by energy prices, the pound sterling's brutal drop in the last few weeks could prod the BoE to maintain the status quo for a few more months. The timing of the first rate cut is thus uncertain, but there is a very strong probability that it will happen before the end of this year.

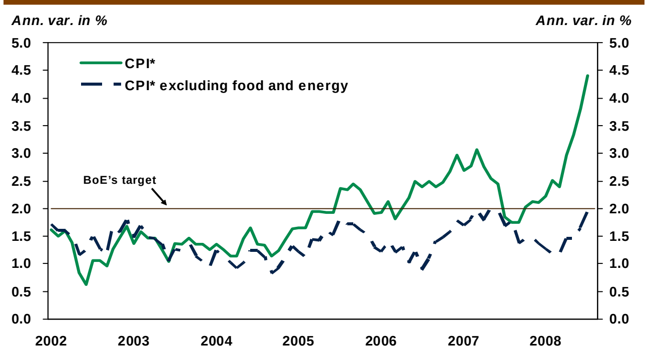
### EUROPEAN CENTRAL BANK (ECB)

To no one's surprise, the ECB kept its key rate at 4.25% this morning. The monetary authorities are still concerned about the risks that elevated inflation will pass through to wages. Of course, Euroland inflation is showing its first signs of flagging. However, at 3.8%, almost twice the ECB's target ceiling, it is still too early to look for interest rate cuts.

With the rapid correction of oil prices, the highly rhetorical ECB will be able to soften its stance so as to take the ongoing euro zone slowdown into greater account. Growth was weaker than the ECB had anticipated in the second quarter, and there are several signs pointing to a strong risk of greater softness in the third quarter. In particular, the IFO index's abrupt tumble in July and August shows that Germany is about to go into recession.

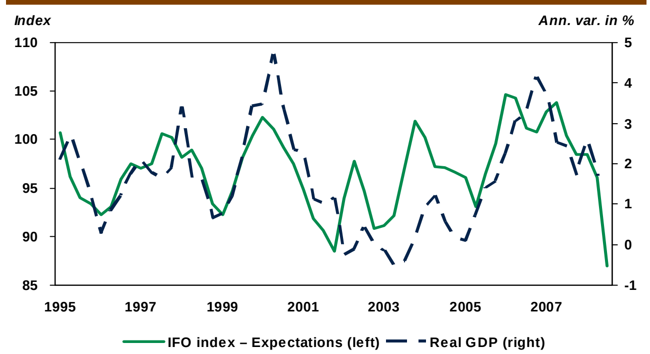
**Implications:** It is too early to hope for rate cuts. Unless oil prices post a spectacular rebound, we should see the first rate cuts in early 2009.

United Kingdom – The surge of inflation ties the BoE's hands




* Consumer price index.
Sources: Datastream and Desjardins, Economic Studies

Euro zone – The IFO index's tumble in July and August points to a clear economic slowdown for Germany




Sources: Datastream and Desjardins, Economic Studies

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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.

## EXCERPT FROM THE EUROPEAN CENTRAL BANK PRESS RELEASE

"[...] On the basis of our regular economic and monetary analyses, at today's meeting we decided to leave the key ECB interest rates unchanged. The information that has become available since the last meeting has confirmed that annual inflation rates are likely to remain well above levels consistent with price stability for a protracted period of time and that upside risks to price stability over the medium term prevail. While the growth of broad money and credit aggregates is now showing some signs of moderation, the still strong underlying pace of monetary expansion points to continued upside risks to price stability over the medium term. The latest economic data also confirm the weakening of real GDP growth in mid-2008. This reflects partly an expected technical reaction to the strong growth seen in the first quarter as well as dampening effects from global and domestic factors, including direct and indirect effects from high commodity prices. In this environment, it remains imperative to avoid broad-based second-round effects in price and wage-setting. In full accordance with our mandate, we emphasise that maintaining price stability in the medium term is our primary objective and that we are resolute in our 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 support sustainable growth and employment. On the basis of our assessment, the current monetary policy stance 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 |
|---|---|---|---|
| **June 2008** | | | |
| 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 |
| **July 2008** | | | |
| 1 | Reserve Bank of Australia | s.q. | 7.25 |
| 3 | European Central Bank | +25 b.p. | 4.25 |
| 3 | Bank of Sweden | +25 b.p. | 4.50 |
| 10 | Bank of England | s.q. | 5.00 |
| 15 | Bank of Canada | s.q. | 3.00 |
| 15 | Bank of Japan | s.q. | 0.50 |
| 18 | Bank of Mexico | +25 b.p. | 8.00 |
| 23 | Reserve Bank of New Zealand | s.q. | 8.00 |
| 23 | Bank of Brazil | +75 b.p. | 13.00 |
| **August 2008** | | | |
| 5 | Reserve Bank of Australia | s.q. | 7.25 |
| 5 | Federal Reserve | s.q. | 2.00 |
| 7 | Bank of England | s.q. | 5.00 |
| 7 | European Central Bank | s.q. | 4.25 |
| 13 | Bank of Norway | s.q. | 5.75 |
| 15 | Bank of Mexico | +25 b.p. | 8.25 |
| 18 | Bank of Japan | s.q. | 0.50 |
| **September 2008** | | | |
| 2 | Reserve Bank of Australia | -25 b.p. | 7.00 |
| 3 | Bank of Canada | s.q. | 3.00 |
| 4 | Bank of England | s.q. | 5.00 |
| 4 | European Central Bank | s.q. | 4.25 |
| 4 | Bank of Sweden | +25 b.p. | 4.75 |

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

### Table 2
### Coming soon

| Date | Central Bank |
|---|---|
| **September 2008** | |
| 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 |
| **October 2008** | |
| 2 | European Central Bank |
| 6 | Bank of Japan |
| 7 | Reserve Bank of Australia |
| 9 | Bank of England |
| 17 | Bank of Mexico |
| 21 | Bank of Canada |
| 22 | Reserve Bank of New Zealand |
| 23 | Bank of Sweden |
| 29 | Bank of Norway |
| 29 | Bank of Brazil |
| 29 | Federal Reserve |
| 30 | Bank of Japan |
| **November 2008** | |
| 3 | Reserve Bank of Australia |
| 6 | Bank of England |
| 6 | European Central Bank |
| 20 | Bank of Japan |
| 28 | Bank of Mexico |
| **December 2008** | |
| 1 | Reserve Bank of Australia |
| 3 | Reserve Bank of New Zealand |

Source: Desjardins, Economic Studies