

October 21, 2008

BANK OF CANADA

Key rates come down, with other cuts to follow

ACCORDING TO THE BANK OF CANADA (BoC)

- The target for the overnight rate is lowered by 25 basis points to 2.25%.
- The intensification of the global crisis has led to severe strains in financial markets.
- The global economy is heading into a mild recession, led by a U.S. economy already in recession.
- There have been sharp declines in many commodity prices, so the deterioration in Canada's terms of trade (ratio of export prices to import prices) will slow domestic demand growth.
- Canadian economic growth will be anemic until the end of Q1 of 2009, then accelerate to reach potential in 2010.
- Inflation pressures will continue to moderate. Core inflation will remain below 2% until the end of 2010. Total CPI inflation could fall below 1% in mid-2009.
- Some further monetary stimulus is likely to be required in Canada.

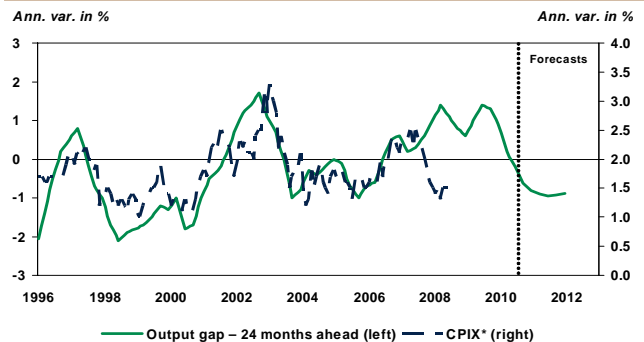
COMMENTS

As we forecast, the BoC opted to continue easing its monetary policy, lowering its key rate by 25 basis points this morning. This follows the bigger 50 basis point cut ordered on October 8, in conjunction with other major central banks. Most of the forecasters in the consensus had anticipated a more aggressive, 50 basis point cut, but Canada's economic and financial context, though worrisome, did not justify lowering interest rates by 100 basis points in just two weeks.

That said, using a more gradual approach, there will be further rate cuts by early 2009. The combined effects of the credit crisis, U.S. recession and softening global demand for natural resources will continue to play against Canada's economy in the next few quarters. The downward impact that tumbling commodity prices have had on the Canadian dollar will help rein in the contraction in net exports. However, the flip side of the coin is that the reversal of wealth effects will have repercussions for domestic demand growth. Consequently, the BoC has slashed its growth outlook to 0.6% for 2008 and 2009, forecasts that are much more in line with our scenario.

Against the backdrop of an economic slowdown and a sharp correction by oil prices, it was clear that the BoC would trim its inflation projection as well. According to our estimates, total inflation will remain high in September (3.4%), but the sharper-than-forecast drop by oil prices should bring the CPI's annual change to less than 1.0% as of mid-2009. Because the output gap has widened, core inflation will stay below 2.0% over the medium term.

The softness of Canada's economy promises to be deflationary



* Consumer price index excluding the eight most volatile components.
Sources: Statistics Canada and Desjardins, Economic Studies

Implications: It remains to be seen how the unprecedented actions by the globe's major financiers and governments will affect credit conditions, but the inflation risks are now clearly tilted to the downside, and it seems clear that further rate cuts will be ordered over the next few months. We are anticipating at least two other 25 basis point rate cuts at the December and January meetings.

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EXCERPT FROM THE BANK OF CANADA PRESS RELEASE



“[...] Three major interrelated developments are having a profound impact on the Canadian economy. First, the intensification of the global financial crisis has led to severe strains in financial markets [...] Second, the global economy appears to be heading into a mild recession [...] Third, there have been sharp declines in many commodity prices. The outlook for growth and inflation in Canada is now more uncertain than usual.

[...] The Bank expects growth to be sluggish through the first quarter of next year, then to pick up over the rest of 2009 and to accelerate to above-potential growth in 2010 supported by improving credit conditions, the lagged effects of monetary policy actions and stronger global growth [...] Overall, the Bank projects average annual growth in real GDP of 0.6 per cent in both 2008 and 2009, and 3.4 per cent in 2010.

With excess supply projected to build throughout 2009 and lower assumed energy prices, inflationary pressures will ease significantly relative to the projection in the July *Monetary Policy Report Update*. Core inflation is now projected to remain below 2 per cent until the end of 2010. Total CPI inflation should peak during the third quarter of 2008, fall below 1 per cent in the middle of 2009, and then return to the 2 per cent target by the end of 2010.

[...] In line with the new outlook, some further monetary stimulus will likely be required to achieve the 2 per cent inflation target over the medium term [...].”

**Table 1
Schedule and key rates**

Date	Central Bank	Decision	Rate
August 2008			
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
12	Reserve Bank of New Zealand	-50 b.p.	7.50
19	Bank of Brazil	+75 b.p.	13.75
16	Bank of Japan	s.q.	0.50
20	Federal Reserve	s.q.	2.00
25	Swiss National Bank	s.q.	2.75
25	Bank of Mexico	s.q.	8.25
24	Bank of Norway	s.q.	5.75
October 2008			
2	European Central Bank	s.q.	4.25
6	Reserve Bank of Australia	-100 b.p.	6.00
6	Bank of Japan	s.q.	0.50
8	European Central Bank	-50 b.p.	3.75
8	Bank of England	-50 b.p.	4.50
8	Bank of Sweden	-50 b.p.	4.25
8	Bank of Canada	-50 b.p.	2.50
8	Swiss National Bank	-25 b.p.	2.50
8	Federal Reserve	-50 b.p.	1.50
17	Bank of Mexico	s.q.	8.25
21	Bank of Canada	-25 b.p.	2.25

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

**Table 2
Coming soon**

Date	Central Bank
October 2008	
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
4	Bank of England
4	European Central Bank
9	Bank of Canada
10	Bank of Brazil
11	Swiss National Bank
16	Federal Reserve
17	Bank of Sweden
18	Bank of Japan
January 2009	
8	Bank of England
15	European Central Bank
20	Bank of Canada
21	Bank of Brazil
22	Bank of Japan

Source: Desjardins, Economic Studies