

October 31, 2008

BANK OF JAPAN

BoJ cuts key interest rate: a first in seven years

ACCORDING TO THE BANK OF JAPAN (BoJ)

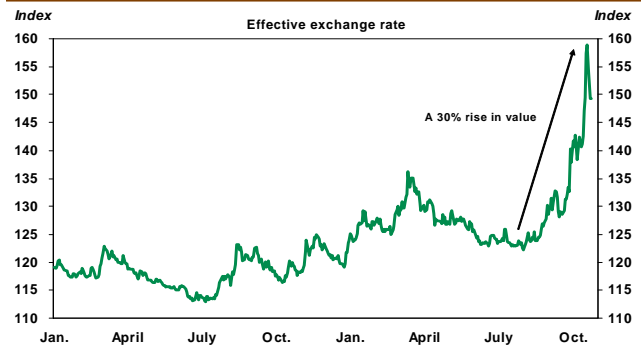
- The key interest rate was cut by 20 basis points, to 0.30%.
- This decision was not unanimous among the members of the monetary policy committee. The president sought to satisfy everyone by opting for a cut that was less than 25 basis points.
- It was also decided to cut interest on loans to financial institutions at 0.25%, and to enact a temporary measure to remunerate excess reserves deposited at the central bank at a rate of 0.1%.
- The risks for economic growth are trending downward. In view of the current international context, the economic difficulties in Japan are expected to last for a few more quarters against a backdrop of falling exports.
- Total inflation remains relatively high; however, the BoJ believes that inflationary risks are now less of a concern and will continue to weaken.

COMMENTS

Just a few weeks ago, few would have believed that the BoJ would elect to cut its key interest rate. Since February 2007, the monetary policy was set at a fair level while authorities waited for an upturn in inflation to continue to increase rates. The BoJ even skipped the chance to take part in the concerted effort made by other major central banks on October 8, stating that its monetary policy was already accommodating enough. But the financial crisis and global economic slowdown are having an impact on Japan's financial data. Japan's stock market has declined to a level last seen in October 1982, and the yen has jumped sharply, stimulated by the unwinding of the carry trade. After getting the green light from the G7 to intervene on the exchange rate, the BoJ went one step further to try to reverse the trend.

The BoJ also published its revised outlooks today. The BoJ forecasts that growth for the 2008 and 2009 fiscal years will fluctuate between 0% and 0.5%, and a return to full potential is not expected before 2010. This weak growth is in addition to deflationary pressures. Up to now, total inflation had been bumped up due to prices for raw materials and energy, but these prices have fallen sharply since. If we exclude food

In spite of Japan's weak economy, the yen is rising due to the unwinding of the carry trade



Sources: Datastream and Desjardins, Economic Studies

and energy, prices in Japan grew by only 0.2% in September (on an annual basis), and a return to deflation now seems more likely.

Implications: Today's decision marks Japan's entry in the global battle to beat the financial crisis. Its aim is to re-assure the markets and stop the yen's rise. Much like the recent decision by the Federal Reserve, the addition of a deposit facility will allow Japan to inject more liquidities without pulling the overnight rate away from its target too much. If Japan does not succeed in this endeavour, it could very well go back to 0% rates and to quantitative easing.

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EXCERPT FROM THE BANK OF JAPAN PRESS RELEASE


“At the Monetary Policy Meeting held today, the Bank of Japan decided, by the chairman’s final decision after a split vote, to set the following guideline for money market operations for the intermeeting period (effective immediately): the Bank of Japan will encourage the uncollateralized overnight call rate to be at around 0.3 percent.”

“Adjustments in the world economy stemming from financial crises in the United States and Europe have further increased in severity. Under these circumstances, increased sluggishness in Japan’s economic activity will likely remain over the next several quarters with exports leveling off and the effects of earlier increases in energy and materials prices persisting. As for prices, consumer price inflation is likely to decline gradually reflecting the recent fall in commodity prices, although it remains relatively high to date. The outlook for economic activity and prices is attended by increased downside risks to economic activity but also by decreased upside risks to inflation relative to the recent past.

[...] the Bank judged that a reduction in policy interest rates and a further increase in the flexibility of money market operations were necessary to maintain accommodative financial conditions [...] To ensure stability in money markets, a temporary measure will be introduced to pay interest on excess reserve balances in order to further facilitate the provisioning of sufficient liquidity toward the year-end and the fiscal year-end [...]

[...] it will likely take some time for the necessary conditions for Japan’s economic recovery to be satisfied.”

**Table 1
Schedule and key rates**

Date	Central Bank	Decision	Rate
September 2008			
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
15	Bank of Norway	-50 b.p.	5.25
17	Bank of Mexico	s.q.	8.25
21	Bank of Canada	-25 b.p.	2.25
22	Reserve Bank of New Zealand	-100 b.p.	6.50
23	Bank of Sweden	-50 b.p.	3.75
29	Bank of Norway	-50 b.p.	4.75
29	Bank of Brazil	s.q.	13.75
29	Federal Reserve	-50 b.p.	1.00
30	Bank of Japan	-20 b.p.	0.30

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

**Table 2
Coming soon**

Date	Central Bank
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
28	Federal Reserve
29	Reserve Bank of New Zealand
February 2009	
3	Reserve Bank of Australia
4	Bank of Norway
5	Bank of England
5	European Central Bank

Source: Desjardins, Economic Studies