

Essentials of the Monetary Policy

November 6, 2008



BANK OF ENGLAND



EUROPEAN CENTRAL BANK

Aggressive 150-point cut to Britain's key rate!

BANK OF ENGLAND (BoE)

The BoE surprised everyone this morning, cutting its key rate by 150 basis points to take it to 3%, a low that dates back to 1955. The action well overshoot analysts' expectations—they had been forecasting that the BoE would opt for 50 points of monetary policy easing. The major financial turmoil and deterioration in the UK's economic outlook justify lowering the key rate rapidly. Britain's economy contracted by a non-annualized 0.5% in the third quarter of 2008, and everything indicates that the severe economic contraction will continue for the near future. The BoE expects the annual inflation rate, at 5.2% in September, to soon drop back sharply on the correction by commodities prices.

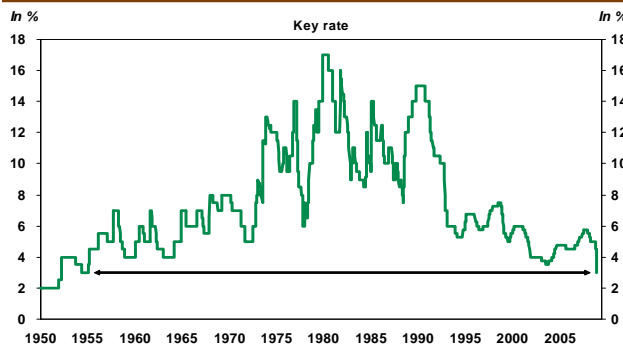
Implications: The BoE was highly proactive, immediately lowering its key rate to where it believes it needs to be, given the serious problems with Britain's economy. The *Inflation Report*, out on November 12, will provide details on the BoE's new economic scenario. Further cuts will probably be needed as the outlook is likely to deteriorate further.

EUROPEAN CENTRAL BANK (ECB)

The ECB was not as aggressive, lowering its key rate by 50 points to 3.25%, as forecast. According to the ECB, the latest data confirm that the economy weakened substantially on sluggish domestic and external demand and tightened credit conditions. On this matter, she emphasizes how important it is for the banking sector to do its job and not overly restrict personal and business credit. The ECB notes that annual inflation has retreated in the euro zone, going from 3.8% in August to 3.2% in October. It expects the trend to persist.

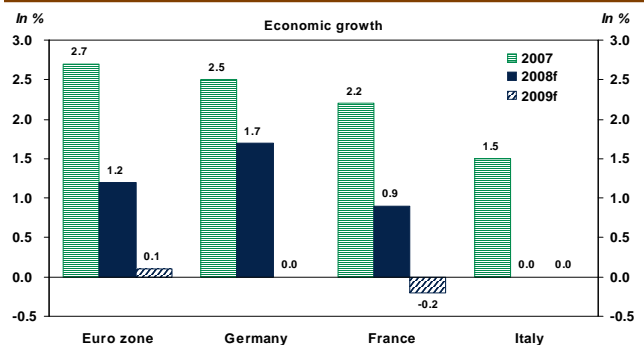
Implications: Even though it may seem small compared with the BoE's, the euro zone's key rate cut is substantial, and clearly demonstrates the ECB's determination to take vigorous action to rein in the economic slowdown. Monetary authorities still hesitate to talk openly about a recession, but the European Commission's latest forecasts show the scope of the problem clearly. The option of a 75-basis-point cut was even discussed this morning, and the door is wide open for further easing in the months to come.

The BoE puts its key rate at its lowest point since January 1955



Sources: Datastream and Desjardins, Economic Studies

Economic growth in the euro zone will brake sharply in 2009



f: European Commission forecasts
Sources: European Commission 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.

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EXCERPT FROM THE BANK OF ENGLAND PRESS RELEASE


« [...] The past two months have seen a substantial downward shift in the prospects for inflation in the United Kingdom. There has been a very marked deterioration in the outlook for economic activity at home and abroad. Moreover, commodity prices have fallen sharply.

Since mid-September, the global banking system has experienced its most serious disruption for almost a century. While the measures taken on bank capital, funding and liquidity in several countries, including our own, have begun to ease the situation, the availability of credit to households and businesses is likely to remain restricted for some time. As a consequence, money and credit conditions have tightened sharply [...]

In the United Kingdom, output fell sharply in the third quarter. Business surveys and reports by the Bank's regional Agents point to continued severe contraction in the near term [...]

[...] In recent weeks, the risks to inflation have shifted decisively to the downside. As a consequence, the Committee has revised down its projected outlook for inflation which, at prevailing market interest rates, contains a substantial risk of undershooting the inflation target. At its November meeting, the Committee therefore judged that a significant reduction in Bank Rate was necessary now in order to meet the 2% target for CPI inflation in the medium term, and accordingly lowered Bank Rate by 1.5 percentage points to 3.0% [...] »

**Table 1
Schedule and key rates**

Date	Central Bank	Decision	Rate
September 2008			
10	Bank of Brazil	+75 b.p.	13.75
16	Bank of Japan	s.q.	0.50
16	Federal Reserve	s.q.	2.00
18	Swiss National Bank	s.q.	2.75
19	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
November 2008			
3	Reserve Bank of Australia	-75 b.p.	5.25
6	Bank of England	-150 b.p.	3.00
6	European Central Bank	-50 b.p.	3.25

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

**Table 2
Coming soon**

Date	Central Bank
November 2008	
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
10	Bank of Sweden
19	Bank of Japan

Source: Desjardins, Economic Studies