

# Essentials of the Monetary Policy

December 4, 2008



## BANK OF ENGLAND



## EUROPEAN CENTRAL BANK

### Aggressive rate cuts in Europe

#### BANK OF ENGLAND (BoE)

The BoE lowered its key rate by 100 basis points this morning. The additional substantial monetary easing takes Britain's key rate to 2%—at the beginning of October, the rate was 5%. Most analysts expected the move. November's Inflation Report clearly indicated that further substantial rate cuts would be needed to keep the inflation rate from falling below the 2% target over the medium term. In the statement that accompanied this morning's decision, the BoE notes that business surveys have weakened further, suggesting that the economic downturn has increased its pace.

**Implication:** Like the British government, which recently announced an economic stimulus plan, the BoE realizes that the United Kingdom is heading for a deep recession. Despite this morning's cut, fears of too steep a decline by inflation, or even deflation, are still present. The BoE should therefore continue to lower its key rate over the next few months to a low of 1% or even below that.

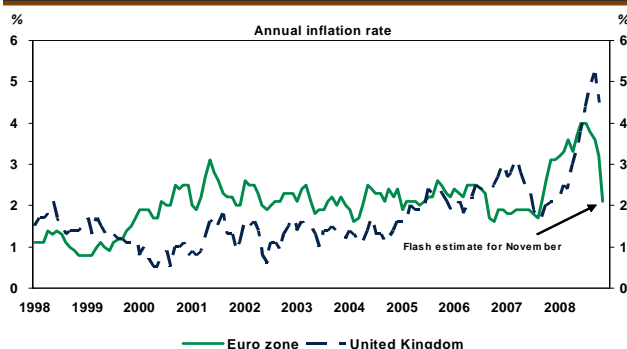
#### EUROPEAN CENTRAL BANK (ECB)

As we expected, the ECB decided to speed up its monetary easing this morning, lowering its key rate by 75 basis points to 2.5%. The Eurosystem's latest projections indicate that the economy's difficulties will persist for the next few quarters. Forecast real GDP growth for the euro zone ranges from -1% to 0% for 2009 and from 0.5% to 1.5% for 2010. The economic risks are still tilted to the downside.

November's flash estimate shows that annual inflation has declined from 3.2% to 2.1%. The Eurosystem's inflation outlook now calls for inflation to be between 1.1% and 1.7% in 2009 and between 1.5% and 2.1% in 2010.

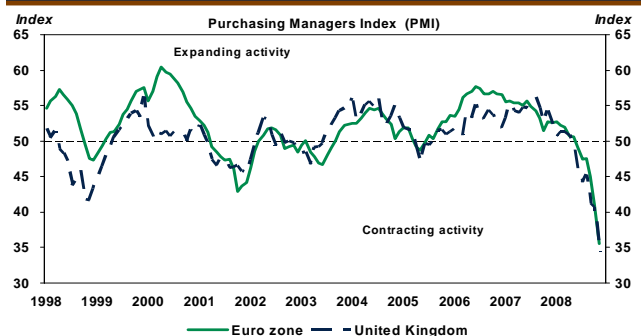
**Implication:** The cut—the biggest in the ECB's history—did not really surprise the markets, although most analysts had anticipated a 50 basis point cut. The latest economic projections confirm that inflation could fall below the ECB's target level (under but close to 2%) next year. The euro zone's key rate should come down to around 1.5% in the next few months.

Inflation will continue to decline in Europe ...



Sources: Datastream and Desjardins, Economic Studies

... as the economic downturn intensifies



Sources: Bloomberg 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 EUROPEAN CENTRAL BANK PRESS RELEASE**


« [...] On the basis of its regular economic and monetary analyses, the Governing Council decided to reduce the key ECB interest rates by a further 75 basis points. This step follows the two 50-basis point reductions in the key ECB interest rates announced on 8 October and 6 November 2008. Overall, since our last meeting, the evidence that inflationary pressures are diminishing further has increased and, looking forward, inflation rates are expected to be in line with price stability over the policy-relevant horizon, supporting the purchasing power of incomes and savings. The decline in inflation rates is due mainly to the fall in commodity prices and the significant slowdown in economic activity. Largely related to the effects of the intensification and broadening of the financial turmoil, both global demand and euro area demand are likely to be dampened for a protracted period of time. At the same time, while the underlying pace of monetary expansion has remained strong, it has continued to decelerate further. All in all, the level of uncertainty remains exceptionally high. The Governing Council will continue to keep inflation expectations firmly anchored in line with its medium-term objective. In so doing, it supports sustainable growth and employment and contributes to financial stability. Accordingly, 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>October 2008</b>			
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
<b>November 2008</b>			
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
20	Bank of Japan	s.q.	0,30
28	Bank of Mexico	s.q.	8,25
<b>December 2008</b>			
1	Reserve Bank of Australia	-100 b.p.	4,25
3	Reserve Bank of New Zealand	-150 b.p.	5,00
4	Bank of England	-100 b.p.	2,00
4	European Central Bank	-75 b.p.	2,50

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

**Table 2  
Coming soon**

Date	Central Bank
<b>December 2008</b>	
9	Bank of Canada
10	Bank of Brazil
11	Swiss National Bank
16	Federal Reserve
17	Bank of Sweden
18	Bank of Japan
<b>January 2009</b>	
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
<b>February 2009</b>	
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
<b>March 2009</b>	
3	Reserve Bank of Australia
3	Bank of Canada
5	Bank of England
5	European Central Bank
11	Bank of Brazil
12	Reserve Bank of New Zealand
12	Swiss National Bank

Source: Desjardins, Economic Studies