

January 15, 2009

EUROPEAN CENTRAL BANK

The key rate is lowered, but Trichet points at a break in February

ACCORDING TO THE EUROPEAN CENTRAL BANK (ECB)

- The Governing Council opted to lower the key rate by 50 basis points, setting it at 2.00%.
- Inflation pressures have continued to ebb, especially as the economic outlook becomes steadily grimmer.
- The euro zone's inflation rate is still expected to be in line with price stability over the medium range.
- After today's decision, the risks to price stability are broadly balanced.
- The euro zone is undergoing a substantial downturn, largely associated with the impacts of the deepening and broadening of financial strain.
- All in all, the level of uncertainty remains exceptionally high.

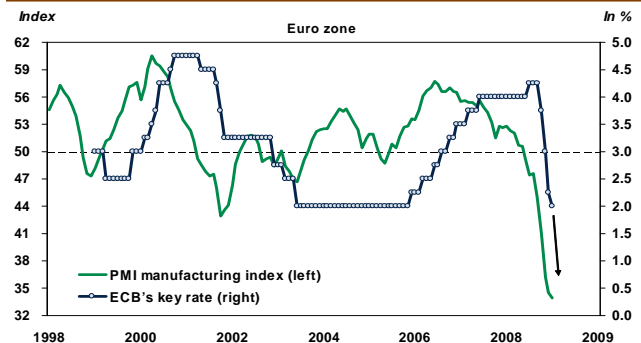
COMMENTS

As expected, the ECB joined the consensus, lowering its key rate by 50 basis points to 2.00% at its January meeting. Since the monetary easing cycle began in October, cuts now total 225 basis points. Note that, in January, ECB President Jean-Claude Trichet had announced that there was a limit to lowering key rates. He was gainsaid by the economic context's rapid deterioration and ongoing financial turmoil.

The latest statistics confirm that the recession, which began in the spring of 2008, will be painful. Retail sales and industrial production are pulling back on a year-over-year basis. Nothing points to any improvement, as the household and business confidence indexes continue to slide. The decline in economic activity and collapse of resource prices have completely wiped out the inflation pressure. Inflation has gone from 4.0% in July to 1.6% in December and the main risk now is clearly overly low or even negative inflation.

In this context, the ECB has all the leeway it needs to continue with monetary easing. At the press conference, the ECB's President announced that the next major meeting would be in March, but the severity of the downturn could prompt him to move up rate cuts again. It should be noted that, at 2.00%, the euro zone still has the highest key rates among the G7 nations.

The ECB has some catching up to do to kick-start Euroland's economy



Sources: Datastream and Desjardins, Economic Studies

Implications: In our opinion, the risks are still broadly tilted to the downside. To cushion the euro zone recession's severity and get inflation back into line with the mean target over the medium range, it seems clear that more rate cuts will be ordered in the next few months. The likelihood of another 50 basis point rate cut as early as February cannot be ruled out. Although the ECB now seems to want to go slowly, the tough economic and financial context could prod it to take its rate to just 1.00% in the first half of 2009. This means that the euro, which rebounded on the chance of a pause in February, should continue downward in the next few months.

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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 interest rate on the main refinancing operations of the Eurosystem by a further 50 basis points, bringing the total reduction since 8 October 2008 to 225 basis points. Today’s decision takes into account that inflationary pressures have continued to diminish, owing in particular to the further weakening in the economic outlook. Looking forward, we continue to expect inflation rates in the euro area to be in line with price stability over the policy-relevant medium-term horizon, thereby supporting the purchasing power of incomes and savings. After today’s decision we consider risks to price stability over the medium term to be broadly balanced. This takes into account the latest economic data releases and survey information, which add clear further evidence to the assessment that the euro area is experiencing a significant slowdown, 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. Monetary expansion is moderating further, supporting the assessment that inflationary pressures and risks are diminishing. 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 of inflation rates below, but close to, 2%. This 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
October 2008			
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
6	Swiss National Bank	-50 b.p.	2.00
20	Bank of Japan	s.q.	0.30
20	Swiss National Bank	-100 b.p.	1.00
28	Bank of Mexico	s.q.	8.25
December 2008			
1	Reserve Bank of Australia	-100 b.p.	4.25
1	Bank of Japan	s.q.	0.30
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
4	Bank of Sweden	-175 b.p.	2.00
9	Bank of Canada	-75 b.p.	1.50
10	Bank of Brazil	s.q.	13.75
11	Swiss National Bank	-50 b.p.	0.50
16	Federal Reserve	-100 b.p. / -75 b.p.	0.00 / 0.25
17	Bank of Norway	-175 b.p.	3.00
18	Bank of Japan	-20 b.p.	0.10
January 2009			
8	Bank of England	-50 b.p.	1.50
15	European Central Bank	-50 b.p.	2.00

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

**Table 2
Coming soon**

Date	Central Bank
January 2009	
16	Bank of Mexico
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
12	Bank of Mexico
March 2009	
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
17	Bank of Japan
17	Federal Reserve
20	Bank of Mexico
25	Bank of Norway
April 2009	
2	European Central Bank
7	Reserve Bank of Australia

Source: Desjardins, Economic Studies