



BANK OF ENGLAND

The U.K.'s key rate continues to head for zero while the European Central Bank pauses

ACCORDING TO THE BANK OF ENGLAND (BoE)

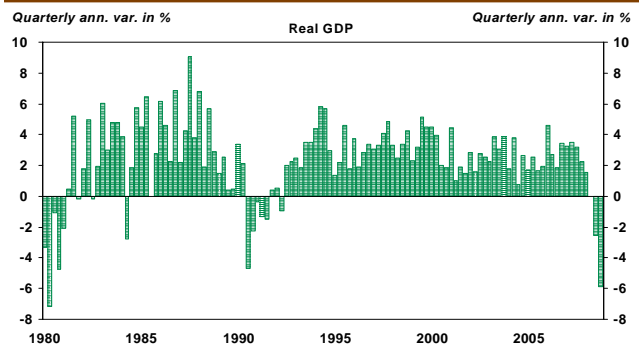
- The key rate has been lowered 50 basis points to 1.00%.
- The global economy is in the throes of a severe and synchronised downturn. The weakness of the global banking and financial system means that the supply of credit remains constrained.
- In the United Kingdom, output dropped sharply in the fourth quarter of 2008 and business surveys point to a similar rate of decline in the early part of this year.
- Inflation fell to 3.1% in December. Pay pressures have diminished. But sterling has continued to depreciate, boosting the cost of imports. Inflation is expected to fall to below the 2% target by the second half of the year.
- Although the transmission mechanism of monetary policy was impaired, past cuts in Bank Rate would in due course nevertheless have a significant impact. Together with the recent easing in fiscal policy, the substantial fall in sterling and past falls in commodity prices, that would provide a considerable stimulus to activity as the year progressed. Nevertheless, the Committee judged that there remained a substantial risk of undershooting the 2% inflation target in the medium term.

COMMENTS

To no one's surprise, the BoE once again lowered its key rate by 50 basis points this morning, putting it at 1.00%. In addition to fearing inflation will be too low over the medium term, the BoE is very concerned about the ongoing crisis that is affecting the financial system. Governor Mervyn King recently declared that the priority should be fixing the banking system. To do so, the Brown government is adding to assistance plans for the banking system, recently expanding the BoE's powers to allow it to buy a wide range of financial assets.

The recession in the United Kingdom has now been made official. Everything suggests it will be a very painful one. In the fourth quarter of 2008, the real GDP posted its biggest contraction in over 25 years and, as the BoE notes, all signs

At the end of 2008, Britain's economy recorded its worst quarter since the early 80s



Sources: Office for National Statistics and Desjardins, Economic Studies

are that activity will continue to decline in the coming months. In this context, annual inflation, which fell from a peak of 5.2% in September 2008 to 3.1% in December, should continue to decline. In our opinion, the inflation pressure stemming from the pound's pullback will be by far insufficient to offset all of the other deflationary pressures.

Implications: This morning's decision confirms that the BoE is being pragmatic. It understands how important it is to do everything it can to support the British economy and financial system, which are undergoing their worst crisis in several decades. The key rate should thus go to zero in the next few months, as the BoE prepares to take non-traditional measures, like the Federal Reserve. The BoE's action and stance contrast with those taken by the European Central Bank which, as it had intimated, decided to take a pause this morning. The markets seem to like the BoE's more proactive attitude, as the pound went up against the euro after the two decisions.

Mathieu D'Anjou
Senior Economist

François Dupuis
Vice-President and Chief Economist

Yves St-Maurice
Director and Deputy Chief Economist

Mathieu D'Anjou
Senior Economist

Martin Lefebvre
Senior Economist

Hendrix Vachon
Economist

514-281-2336 or 1 866 866-7000, ext. 2336
E-mail: desjardins.economics@desjardins.com

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EXCERPT FROM THE BANK OF ENGLAND PRESS RELEASE


“ [...] The global economy is in the throes of a severe and synchronised downturn. Output in the advanced economies fell sharply in the fourth quarter of 2008, and growth in the emerging market economies appears to have slowed markedly. Business and household sentiment in many countries has deteriorated. The weakness of the global banking and financial system means that the supply of credit remains constrained.

In the United Kingdom, output dropped sharply in the fourth quarter of 2008 and business surveys point to a similar rate of decline in the early part of this year. Credit conditions faced by companies and households have tightened further. The underlying picture for consumer spending appears weak. Businesses have responded to the worsening outlook by running down inventories, cutting production, scaling back investment plans and shedding labour [...]

CPI inflation fell to 3.1% in December. Pay pressures have diminished. But sterling has continued to depreciate, boosting the cost of imports. Inflation is expected to fall to below the 2% target by the second half of the year, reflecting waning contributions from retail energy and food prices and the direct impact of the temporary reduction in Value Added Tax [...]

[...] the past cuts in Bank Rate would in due course nevertheless have a significant impact. Together with the recent easing in fiscal policy, the substantial fall in sterling and past falls in commodity prices, that would provide a considerable stimulus to activity as the year progressed. Nevertheless, the Committee judged that there remained a substantial risk of undershooting the 2% CPI inflation target in the medium term at the existing level of Bank Rate. Accordingly, the Committee concluded that a further reduction in Bank Rate of 0.5 percentage points to 1.0% was warranted this month [...]

**Table 1
Schedule and key rates**

Date	Central Bank	Decision	Rate
November 2008			
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
16	Bank of Mexico	-50 b.p.	7.75
20	Bank of Canada	-50 b.p.	1.00
21	Bank of Brazil	-100 b.p.	12.75
21	Bank of Japan	s.q.	0.10
28	Reserve Bank of New Zealand	-150 b.p.	3.50
28	Federal Reserve	s.q.	0.00 / 0.25
February 2008			
3	Reserve Bank of Australia	-100 b.p.	3.25
4	Bank of Norway	-50 b.p.	2.50
5	Bank of England	-50 b.p.	1.00
5	European Central Bank	s.q.	2.00

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

**Table 2
Coming soon**

Date	Central Bank
February 2009	
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
7	Bank of Japan
9	Bank of England
17	Bank of Mexico
20	Bank of Sweden
21	Bank of Canada
28	Bank of Japan
29	Bank of Brazil
29	Federal Reserve
30	Reserve Bank of New Zealand
May 2009	
5	Reserve Bank of Australia

Source: Desjardins, Economic Studies