Essentials of the Monetary Policy
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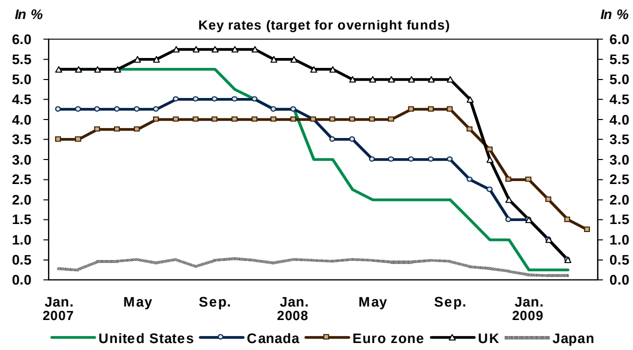
EUROPEAN CENTRAL BANK

The key rate comes down… but less than forecast!

ACCORDING TO THE EUROPEAN CENTRAL BANK (ECB)

- The Governing Council opted to lower the key rate by 25 basis points, setting it at 1.25%.
- Inflation pressure will remain contained, reflecting past declines in commodity prices and the sharp downturn in economic activity.
- Signs of widespread reductions in inflation pressures are increasingly emerging.
- The latest surveys and economic statistics confirm that the global economy, including the euro zone, is contracting sharply.
- World and Euroland demand will likely remain very soft in 2009, then gradually improve in the course of 2010.

The ECB is behind the curve in terms of its peers' monetary easing cycles



Sources: Datastream and Desjardins, Economic Studies

COMMENTS

Clearly, the ECB keeps surprising us. While all of the other major central banks have arrived at some form of quantitative easing to kick start their economies, the ECB is slowing the pace of its monetary easing. The 25 basis point cut does take the key rate to 1.25%, the lowest level recorded since the euro zone was formed. However, the severity of this recession suggests that this is not the time for contemplation: action is urgently needed. The global synchronization of the economic downturn is just making things worse, and the ECB has a critical role to play in reversing the situation.

The ECB acknowledges that, in the context of a global downturn, pressure on prices will remain contained; however, it does not think that deflation risks will materialize. Yet, at this rate, it seems clear that the inflation underlying Euroland's economy will be on a net down trend until 2010.

Under these circumstances, the ECB's work is not done. At the press conference, President Jean-Claude Trichet also announced that 1.25% did not constitute a floor. Further cuts are probably on the way at upcoming meetings. However, it is likely that more quantitative measures, perhaps targeting business credit, may be implemented without the ECB necessarily taking its key rate close to zero.

Implications: The ECB has indicated that the size of rate cuts will be more measured starting now. Due to the deterioration in the economic context, the door is open for another 25 basis point cut at the May meeting. 1.00% could be a difficult psychological threshold for the ECB to cross.

Martin Lefebvre
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

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 25 basis points. This decision brings the total reduction in the interest rate on the main refinancing operations of the Eurosystem since 8 October 2008 to 300 basis points.

Today's decision takes into account the expectation that price pressures will remain subdued, reflecting the substantial past fall in commodity prices and the marked weakening of economic activity in the euro area and globally. The latest economic data and survey information confirm that the world economy, including the euro area, is undergoing a severe downturn. Both global and euro area demand are likely to remain very weak over 2009, before gradually recovering in the course of 2010. Available indicators of inflation expectations over the medium to longer term remain firmly anchored in line with the Governing Council's aim of keeping inflation rates at levels below, but close to, 2% over the medium term. A cross-check with the outcome of the monetary analysis confirms that inflationary pressure has been diminishing. After today's decision we expect price stability to be maintained over the medium term, thereby supporting the purchasing power of euro area households. The Governing Council will continue to ensure a firm anchoring of medium-term inflation expectations. Such anchoring is indispensable to supporting 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*
January 2009			
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
11	Bank of Sweden	-100 b.p.	1.00
18	Bank of Japan	s.q.	0.10
20	Bank of Mexico	-25 b.p.	7.50
March 2008			
2	Reserve Bank of Australia	s.q.	3.25
3	Bank of Canada	-50 b.p.	0.50
5	Bank of England	-50 b.p.	0.50
5	European Central Bank	-50 b.p.	1.50
11	Reserve Bank of New Zealand	-50 b.p.	3.00
11	Bank of Brazil	-150 b.p.	11.25
12	Swiss National Bank	-25 b.p.	0.25
17	Bank of Japan	s.q.	0.10
18	Federal Reserve	s.q.	0.00 / 0.25
20	Bank of Norway	-75 b.p.	6.75
25	Bank of Japan	-50 b.p.	2.00
April 2008			
2	European Central Bank	-25 b.p.	1.25

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

Table 2
Coming soon

Date	*Central Bank*
April 2009	
6	Bank of Japan
7	Reserve Bank of Australia
9	Bank of England
17	Bank of Mexico
21	Bank of Sweden
21	Bank of Canada
29	Reserve Bank of New Zealand
29	Bank of Brazil
29	Bank of Japan
29	Federal Reserve
May 2009	
5	Reserve Bank of Australia
6	Bank of Norway
7	Bank of England
7	European Central Bank
15	Bank of Mexico
21	Bank of Japan
June 2009	
2	Reserve Bank of Australia
4	Bank of England
4	European Central Bank
4	Bank of Canada
10	Bank of Brazil
11	Reserve Bank of New Zealand
15	Bank of Japan
17	Bank of Norway
18	Swiss National Bank
19	Bank of Mexico
24	Federal Reserve

Source: Desjardins, Economic Studies