

June 4, 2009

## BANK OF CANADA

### The key rate stays at 0.25%: no additional stimulus in sight for the near future

#### ACCORDING TO THE BANK OF CANADA (BoC)

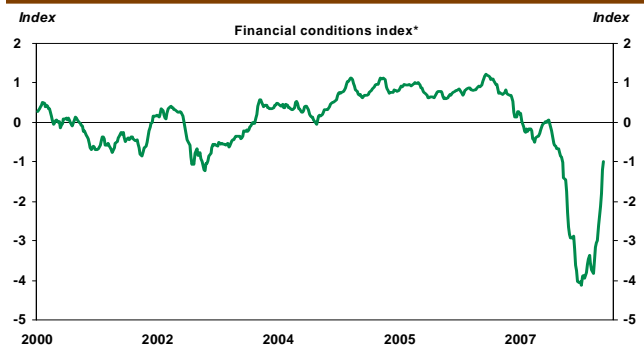
- The target for the overnight rate remains at the 0.25% floor. It will stay at that level until the second quarter of 2010 in order to reach the inflation target.
- The already significant output gap will continue to widen through the third quarter, putting downward pressure on inflation.
- Financial conditions and commodity prices have improved significantly, and consumer and business confidence have recovered modestly. If the Canadian dollar continues to rise, however, it could fully offset these positive factors.
- The outlook is subject to considerable uncertainty. Because the key rate is at its lower bound, the overall risks to the Bank's inflation projection remain tilted slightly to the downside.

#### COMMENTS

Unsurprisingly, the BoC left its key interest rate unchanged at 0.25% this morning. It should be said that, since the Bank undertook to keep the key rate at this level until June 2010 at the April meeting, any other decision would have been controversial. By asserting that it retains considerable flexibility in the conduct of monetary policy, the BoC is keeping the door open to credit and quantitative easing in the event of another shock. However, given the recent improvement to economic and financial conditions, the Bank would have been ill advised to resort to additional unconventional stimulus and it opted to gauge the impact of existing policies.

However, the economy is not doing well and continues to need a solid injection of monetary stimulus. The worst of the storm does appear to be over and the economic cycle is closing in on a turning point. However, in the near term, the outlook is subject to many risks. Core inflation (which excludes food and energy) has been very resilient in the last few months but, in our opinion, the substantial widening of the output gap will put a lot more downside pressure on underlying inflation than the BoC is anticipating. The Bank

#### Financial conditions are still improving substantially



\* Based on interest rate spreads, the money market, the stock market, and standardized to 0.  
Sources: Bloomberg and Desjardins, Economic Studies

has downgraded Canada's potential growth for 2009 and 2010 but, given a modest global economic recovery, the gap between the Canadian economy and production potential will, at best, close in 2013. The other contentious point is the skyrocketing Canadian dollar—the loonie has gained close to 14% since the *Monetary Policy Report* was published in April. As the BoC had based its growth and inflation projections on a much lower loonie, this is an additional risk that the Bank will have to revise its outlook in the next few months.

**Implications:** The risks that inflation will move well below the 2% target in the next few months means that the BoC may have further policy easing to do. However, in the short term, it will be cautious; it will take an additional shock to see it use the less conventional tools it has in its monetary arsenal.

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**EXCERPT FROM THE BANK OF CANADA PRESS RELEASE**

« [...] Information received since the Bank's April Monetary Policy Report (MPR) is broadly consistent with the Bank's medium-term outlook for output and inflation in Canada. The economy is undergoing major restructuring in a number of sectors. The already significant output gap will continue to widen through the third quarter, putting downward pressure on inflation. The Bank continues to expect that the global and Canadian recoveries will be more muted than usual.

In recent weeks, financial conditions and commodity prices have improved significantly, and consumer and business confidence have recovered modestly. If the unprecedentedly rapid rise in the Canadian dollar (which reflects a combination of higher commodity prices and generalized weakness in the U.S. currency) proves persistent, it could fully offset these positive factors.

The outlook is subject to considerable uncertainty. While the underlying macroeconomic risks are roughly balanced, the Bank judges that, as a consequence of operating at the effective lower bound, the overall risks to its inflation projection remain tilted slightly to the downside. Conditional on the outlook for inflation, the target overnight rate can be expected to remain at its current level until the end of the second quarter of 2010 in order to achieve the inflation target. The Bank retains considerable flexibility in the conduct of monetary policy at low interest rates, consistent with the framework outlined in the April MPR. »

**Table 1  
Schedule and key rates**

Date	Central Bank	Decision	Rate
<b>March 2008</b>			
17	Bank of Japan	s.q.	0.10
18	Federal Reserve	s.q.	0.00 / 0.25
20	Bank of Mexico	-75 b.p.	6.75
25	Bank of Norway	-50 b.p.	2.00
<b>April 2008</b>			
2	European Central Bank	-25 b.p.	1.25
6	Bank of Japan	s.q.	0.10
7	Reserve Bank of Australia	-25 b.p.	3.00
9	Bank of England	s.q.	0.50
17	Bank of Mexico	-75 b.p.	6.00
21	Bank of Sweden	-50 b.p.	0.50
21	Bank of Canada	-25 b.p.	0.25
29	Reserve Bank of New Zealand	-50 b.p.	2.50
29	Bank of Brazil	-100 b.p.	10.25
29	Bank of Japan	s.q.	0.10
29	Federal Reserve	s.q.	0.00 / 0.25
<b>May 2008</b>			
5	Reserve Bank of Australia	s.q.	3.00
6	Bank of Norway	-50 b.p.	1.50
7	Bank of England	s.q.	0.50
7	European Central Bank	-25 b.p.	1.00
15	Bank of Mexico	-75 b.p.	5.25
21	Bank of Japan	s.q.	0.10
<b>June 2008</b>			
2	Reserve Bank of Australia	s.q.	3.00
4	Bank of England	s.q.	0.50
4	European Central Bank	s.q.	1.00
4	Bank of Canada	s.q.	0.25

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

**Table 2  
Coming soon**

Date	Central Bank
<b>June 2009</b>	
10	Reserve Bank of New Zealand
10	Bank of Brazil
15	Bank of Japan
17	Bank of Norway
18	Swiss National Bank
19	Bank of Mexico
24	Federal Reserve
<b>July 2009</b>	
2	European Central Bank
2	Bank of Sweden
7	Reserve Bank of Australia
9	Bank of England
14	Bank of Japan
17	Bank of Mexico
21	Bank of Canada
22	Bank of Brazil
29	Reserve Bank of New Zealand
<b>August 2009</b>	
4	Reserve Bank of Australia
6	Bank of England
6	European Central Bank
10	Bank of Japan
12	Bank of Norway
12	Federal Reserve
21	Bank of Mexico
<b>September 2009</b>	
1	Reserve Bank of Australia
2	Bank of Brazil
3	European Central Bank

Source: Desjardins, Economic Studies