

July 2, 2009

EUROPEAN CENTRAL BANK

No more rate cuts in sight!

ACCORDING TO THE EUROPEAN CENTRAL BANK (ECB)

- The Governing Council leaves the key rate at 1.00%.
- Economic activity should remain soft for the rest of the year, while contracting less sharply than it did in the first quarter of 2009. Subsequently, after stabilizing for a while, a gradual recovery with positive quarterly growth rates is expected by mid-2010. The risks to the economic outlooks are balanced.
- The annual inflation rates should remain negative temporarily for the next few months before becoming positive again. These short-term movements are not significant to monetary policy. The risks to the inflation outlook are balanced overall.
- Interest rates are at an appropriate level.

COMMENTS

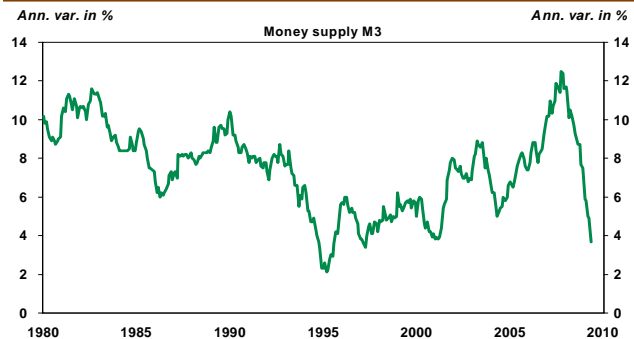
As expected, the ECB left its key rate at 1.00% this morning. Despite the fact that the economy is still struggling, the latest statistics show that the pace at which economic activity is deteriorating is slowing in the euro zone. As a result, interest rates are deemed to be at appropriate levels.

However, the situation is still critical and rates cannot be expected to be increased for several quarters. While the rebound by the confidence and production indexes confirms that the worst of the storm is now behind us, the ongoing deterioration by the employment market (the jobless rate hit 9.5% in May) is still a source of concern for ECB members. With very little inflation pressure emanating from economic activity, the ECB has substantial leeway for ensuring that the impact of low interest rates is fully felt before it takes its policy closer to neutral, particularly since the money supply's annual growth rate—just 3.7%—is low, historically.

To mitigate this situation, the ECB has injected almost €42B in one-year loans into the market over the last few days and it is preparing to buy €60B in covered bonds to facilitate credit and encourage banks to lend.

The ECB is not very concerned about the situation's deflationary impact. The drop by the all-items price index, which essentially reflects the drop in energy prices, promises

Growth in the money supply is at its lowest level since the last recession



Sources: Bloomberg and Desjardins, Economic Studies

to be temporary and is not relevant from a monetary perspective. However, unlike the Fed, the ECB has made a point of letting the markets know that the monetary and credit easing measures will rapidly be rolled back once the situation is somewhat normalized, in order to keep inflation expectations firmly anchored.

Implications: The door is not yet closed but, with the tone of this morning's statement, the likelihood of seeing Euroland's key rates come down further has diminished. As the ECB has decided to use credit easing measures, the 1.00% threshold should be maintained until 2010.

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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 leave the key ECB interest rates unchanged. The current rates remain appropriate taking into account all the information and analyses that have become available since our meeting on 4 June 2009. The fall of annual inflation rates into negative territory in June is in line with previous expectations and reflects mainly temporary effects. After a return to positive inflation rates, we expect price developments to remain dampened over the policy-relevant horizon. Recent data releases and survey information provide further indications that economic activity over the remainder of this year is likely to remain weak but should decline less strongly than was the case in the first quarter of 2009. This assessment incorporates adverse lagged effects, such as a further deterioration in labour markets, which are likely to materialise over the coming months. Looking ahead into next year, after a phase of stabilisation, a gradual recovery with positive quarterly growth rates is expected by mid-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 below, but close to, 2% over the medium term. The outcome of the monetary analysis corroborates the assessment of low inflationary pressure, as money and credit indicators continue to be weak. Against this background, we expect the current episode of extremely low or negative inflation rates to be short-lived and price stability to be maintained over the medium term, thereby continuing to support the purchasing power of euro area households. [...]

**Table 1
Schedule and key rates**

Date	Central Bank	Decision	Rate
April 2008			
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
May 2008			
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
June 2008			
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
10	Reserve Bank of New Zealand	s.q.	2.50
10	Bank of Brazil	-100 b.p.	9.25
15	Bank of Japan	s.q.	0.10
17	Bank of Norway	-25 b.p.	1.25
18	Swiss National Bank	s.q.	0.25
19	Bank of Mexico	-50 b.p.	4.75
24	Federal Reserve	s.q.	0,00 / 0,25
July 2008			
2	European Central Bank	s.q.	1.00
2	Bank of Sweden	-25 b.p.	0.25

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

**Table 2
Coming soon**

Date	Central Bank
July 2009	
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
August 2009	
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
September 2009	
1	Reserve Bank of Australia
2	Bank of Brazil
3	European Central Bank
9	Reserve Bank of New Zealand
10	Bank of England
10	Bank of Canada
16	Bank of Japan
17	Swiss National Bank
18	Bank of Mexico
23	Bank of Norway
23	Federal Reserve
October 2009	
6	Reserve Bank of Australia

Source: Desjardins, Economic Studies