

August 6, 2009

BANK OF ENGLAND

The BoE is taking no chances: it's expanding its asset purchase program by £50B

ACCORDING TO THE BANK OF ENGLAND (BoE)

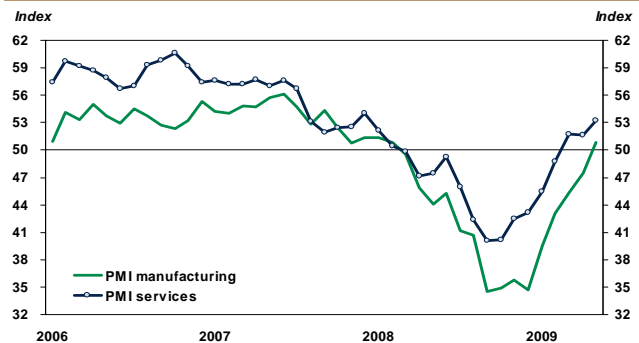
- The official Bank Rate paid on commercial bank reserves remains steady at 0.50%. The asset purchase program financed by the issuance of central bank reserves is increased by £50B to £175B (US\$294B). Purchases should be completed within three months.
- The world economy is still in recession, but growing signs indicate that activity is stabilizing in the United Kingdom's main export markets.
- In the United Kingdom, the recession seems to have been deeper than the BoE previously thought. The GDP fell further in the second quarter, but the pace of the contraction moderated and business surveys suggest that the trough is approaching. Although there are signs that credit conditions may have started to ease, lending to business has fallen and spreads on bank loans remain elevated.
- Despite the anticipated recovery in output growth, the economy's surplus capacity will continue to grow for some time yet, putting downside pressure on inflation over the medium term.

COMMENTS

There were no doubts about the decision to keep the key rate where it is in the United Kingdom. The BoE's dilemma was whether or not to expand its quantitative policy program, which was coming to an end. The end of the purchase program would have removed a support from the economy and Britain's financial system, representing monetary policy firming. Once again, the BoE has taken the risk of doing too much rather than not enough, expanding its program by £50B. This took it above the previous ceiling, requiring the approval of the British government. The markets initially reacted quite violently, taking the pound and gilt rates down.

The BoE's decision is based on a new inflation forecast, which will be presented in its report, scheduled for release on August 12. A reading of the statement suggests that, despite the encouraging economic statistics released recently, the BoE is expecting the economy to post a modest recovery. It thus anticipates that surplus capacity will continue to rise,

The purchasing manager indexes augur a comeback of growth in the United Kingdom



Sources: Bloomberg and Desjardins, Economic Studies

putting downside pressure on inflation. The risk that inflation will evolve under the 2% target over the medium term is certainly a key risk for the BoE, prompting it to take action this morning.

Implications: In a context in which the British government has very little fiscal leeway and the pound sterling is tending to appreciate, we can understand why the BoE is doing everything in its power to support the economic recovery that appears to be nascent in the United Kingdom. The key rate will be kept at this floor for several more months, but further expansions to the asset purchase program may not be needed. The European Central Bank already seems to have made this decision—without completely closing its door to further action, it opted for the status quo this morning.

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NOTE TO READERS: The letters **K**, **M** and **B** are used in texts and tables to refer to thousands, millions and billions respectively.

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EXCERPT FROM THE BANK OF ENGLAND PRESS RELEASE


“The Bank of England’s Monetary Policy Committee today voted to maintain the official Bank Rate paid on commercial bank reserves at 0.5%. The Committee also voted to continue with its programme of asset purchases financed by the issuance of central bank reserves and to increase its size by £50 billion to £175 billion [...]

In the United Kingdom, the recession appears to have been deeper than previously thought. GDP fell further in the second quarter of 2009. But the pace of contraction has moderated and business surveys suggest that the trough in output is close at hand [...] And though there are signs that credit conditions may have started to ease, lending to business has fallen and spreads on bank loans remain elevated.

[...] While some recovery in output growth is in prospect, the margin of spare capacity in the economy is likely to continue to grow for some while yet, bearing down on inflation in the medium term [...]

[...] The Committee expects the announced programme to take another three months to complete. The scale of the programme will be kept under review [...]

The Committee’s latest inflation and output projections will appear in the Inflation Report to be published at 10:30am on Wednesday 12 August [...]

**Table 1
Schedule and key rates**

Date	Central Bank	Decision	Rate
May 2008			
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	European Central Bank	s.q.	1.00
4	Bank of England	s.q.	0.50
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
7	Reserve Bank of Australia	s.q.	3.00
9	Bank of England	s.q.	0.50
14	Bank of Japan	s.q.	0.10
17	Bank of Mexico	-25 b.p.	4.50
21	Bank of Canada	s.q.	0.25
22	Bank of Brazil	-50 b.p.	8.75
29	Reserve Bank of New Zealand	s.q.	2.50
August 2008			
4	Reserve Bank of Australia	s.q.	3.00
6	European Central Bank	s.q.	1.00
6	Bank of England	s.q.	0.50

**Table 2
Coming soon**

Date	Central Bank
August 2009	
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
3	Bank of Sweden
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
8	European Central Bank
8	Bank of England
13	Bank of Japan
16	Bank of Mexico
20	Bank of Canada
21	Bank of Brazil
22	Bank of Norway
23	Reserve Bank of New Zealand
28	Bank of Japan
29	Bank of Sweden

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

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