

September 10, 2009

BANK OF CANADA

BoC more optimistic, but no change to key interest rates before mid-2010

ACCORDING TO THE BANK OF CANADA (BoC)

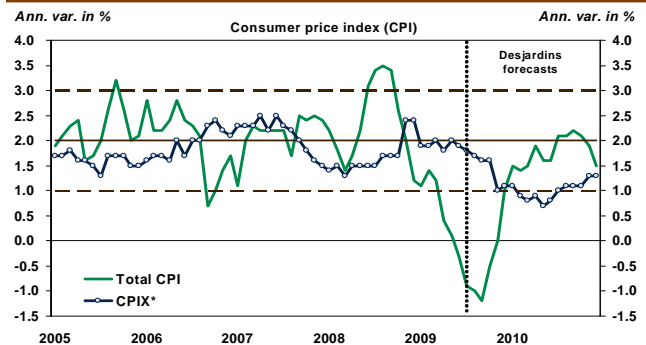
- The target for the overnight rate remains at 0.25%. Depending on what happens to inflation, the target for the overnight rate should be kept at its current level until the end of the second quarter of 2010, in order for the inflation target to be reached.
- The adoption of expansionist monetary and budgetary policies, the improvement in financial conditions, price increases for basic products and rising confidence among businesses and households are supporting growth in Canada's domestic demand.
- GDP growth may prove to be stronger during the second half of 2009 than the BoC was anticipating in July.
- The persistent stamina of the Canadian dollar continues to put growth, and the return of inflation to target levels, at risk.

COMMENTS

As expected, the BoC kept its key interest rate at 0.25% this morning. It also reaffirmed its commitment to keep it at that low level until the end of June 2010. By asserting that it is maintaining considerable flexibility in the way it wields its monetary policy, the BoC is keeping the door open to credit interventions and quantitative easing measures should a further shock strike the economy. However, given the recent improvement in economic and financial conditions, the idea of resorting to further unconventional stimuli is now wishful thinking. Using them to intervene on the exchange rate would have been even more unwise, especially since the BoC's optimism seems once again to be on the upswing. Despite the loonie being stronger than it was when the BoC issued its last assessment in July, the BoC now anticipates that recent developments may herald faster growth than expected in the second half of this year.

Nevertheless, the risks are still considerable, and even renewed growth is not likely to prompt the BoC to rush to tighten its monetary policy. The main concern is still inflation. It is true that the deflation in the total consumer price index appears to be temporary, with the effects of declining oil

Deflation appears to be temporary in Canada, but core inflation is of greater concern



* Excluding the eight most volatile components.
Sources: Statistics Canada and Desjardins, Economic Studies

prices in the second half of last year on the verge of being offset. However, the gap with respect to production potential is substantial and will continue to keep a lid on prices in the years to come. Consequently, the BoC, which expects core inflation (which excludes eight of the most volatile components) to soon reach a low, may have to revise its inflation scenario downwards.

Meanwhile, the vigour of the Canadian dollar will remain a major concern. It will probably not trigger any intervention beyond moral suasion, but it will bolster the BoC's resolve to keep its key interest rate at 0.25% for as long as it said it would.

Implications: Canada should return to growth conditions in the second half of this year, but the recovery is still at too early a stage for us to anticipate a tightening of the monetary policy any time soon.

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

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

IMPORTANT: This document is based on public information, obtained from sources that are deemed to be reliable. Desjardins Group in no way guarantees that the information is complete or accurate. The document is provided solely for information purposes and does not constitute an offer or solicitation for purchase or sale. The document may under no circumstances be construed as a commitment by Desjardins Group, which takes no responsibility for the consequences of any decision made based on the information herein. The prices and rates shown are for information purposes only as they may change at any time based on market conditions. Past returns are no guarantee of future performance, and Desjardins Group does not hereby purport to provide any investment advice. The opinions and forecasts contained herein are, unless otherwise indicated, those of the document's authors and do not represent the official position of Desjardins Group. Copyright © 2009, Desjardins Group. All rights reserved.

EXCERPT FROM THE BANK OF CANADA PRESS RELEASE


“[...] Following a deep, synchronous recession, recent indicators point to the start of recovery in major economies [...]

Stimulative monetary and fiscal policies, improved financial conditions, firmer commodity prices, and a rebound in business and consumer confidence are supporting domestic demand growth in Canada. Combined with recent information on inventory adjustments and automotive production, this suggests that GDP growth in the second half of 2009 could be stronger than the Bank projected in July [...]

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.

[...] as a consequence of operating at the effective lower bound, the overall risks to its inflation projection are tilted slightly to the downside.

Persistent strength in the Canadian dollar remains a risk to growth and to the return of inflation to target [...]

**Table 1
Schedule and key rates**

Date	Central Bank	Decision	Rate
June 2008			
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
10	Bank of Japan	s.q.	0.10
12	Bank of Norway	s.q.	1.25
12	Federal Reserve	s.q.	0.00 / 0.25
21	Bank of Mexico	s.q.	4.50
September 2008			
1	Reserve Bank of Australia	s.q.	3.00
2	Bank of Brazil	s.q.	8.75
3	European Central Bank	s.q.	1.00
3	Bank of Sweden	s.q.	0.25
9	Reserve Bank of New Zealand	s.q.	2.50
10	Bank of England	s.q.	0.50
10	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
September 2009	
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
28	Reserve Bank of New Zealand
28	Bank of Japan
29	Bank of Sweden
November 2009	
2	Reserve Bank of Australia
4	Federal Reserve
5	European Central Bank
5	Bank of England
19	Bank of Japan
27	Bank of Mexico
30	Reserve Bank of Australia
December 2008	
3	European Central Bank
8	Bank of Canada
9	Reserve Bank of New Zealand

Source: Desjardins, Economic Studies