The Bank of Canada opts again for the status quo: key lending rates stay put

In brief

- The overnight funds rate and discount rate remain unchanged: 2.50% and 2.75%, respectively. The prime rate of the Caisse centrale Desjardins will therefore stay at 4.25%.
- Economic growth was a little less swift in the fourth quarter of 2004 compared to what the Bank of Canada had initially estimated.
- The recent rally of the Canadian dollar was a little more bolstered that predicted by the Bank.
- In 2005, the Canadian economy is expected to operate a little further below full potential as anticipated by the Bank in its biannual report on monetary policy (MPR) released last fall.

Commentary

As expected, owing to the recent economic difficulties triggered by the quick and sudden rise of the loonie over the second half of 2004, the Bank of Canada decided to extent the hiatus in its monetary tightening phase. Like its decision made last December, Canada’s key interest rates will remain unchanged.

The results of the Consumer Price Index demonstrated once again last week that inflationary pressures are in check in our country. Not only does the annual inflation rate currently stand close to the median target of the Bank of Canada, but our forecasts show that it should stay in the neighbourhood of 2% over the next few quarters.

The Bank of Canada therefore has all the room to manoeuvre needed to extend the current waiting period. We are convinced that, not earlier than this summer, the Bank of Canada will pursue its monetary adjustment with further hikes in the key interest rates. Meanwhile, the US Federal Reserve will certainly keep on raising its key lending rates, which will cause the gap to close between Canadian and American rates in early February. In fact, the gap might even become negative beginning in March, a situation that would penalize Canadian currency. If we also take into consideration the more sluggish growth of raw material prices, the Canadian dollar will not be able to benefit from as much support over the months ahead, which will stunt its growth and perhaps even trigger a decline. That would clearly be a helping hand to the adjustments under way in the Canadian economy. In closing, We might mention that the Bank of Canada will provide more details on its forecast with this Thursday’s publication of its Monetary Policy Report Update, last updated in November.
Excerpts from the BoC Press Release:

[...] The Canadian economy continues to adjust to major global developments. Recent data suggest that Canada’s economic growth in the fourth quarter of 2004 was marginally weaker than previously expected, owing partly to a somewhat more pronounced adjustment to the past appreciation of the Canadian dollar. Since the December fixed announcement date, the Canadian dollar has continued to trade in a higher range than was observed prior to the October Monetary Policy Report (MPR). In large part reflecting the consequences for aggregate demand of this higher exchange rate, the Bank now expects the Canadian economy to operate a little further below its full production capacity in 2005 than was anticipated in the last MPR. Against this background, the Bank decided to leave the target for the overnight rate unchanged.

The Monetary Policy Report Update, to be released on 27 January 2005, will provide details of the Bank’s outlook for economic growth and inflation through 2006, including the attendant risks and uncertainties, and will consider the related issues for monetary policy. […]