The Bank of Canada's Key Rates Remain Unchanged

The overnight rate and the discount remain unchanged at 2.00% and 2.25% respectively. Therefore, the prime rate will stay at 3.75%.

1) The Canadian economy continues to adjust to developments in international conditions.
2) The strong increase in the world prices of oil has led the Bank of Canada to review upward its forecast for total inflation.
3) On the other hand, the Bank has retained the same outlook for economic expansion and core inflation, which will come back up to 2% before the end of 2005. That means that the hike in oil prices will have no effect on the prices of other goods.
4) The Canadian economy should attain its full potential before the third quarter of 2005.

Conclusion: All 32 of the analysts surveyed by the firm of Bloomberg (ourselves included) expected that the Bank of Canada would opt for the status quo this morning. Even so, in light of the astounding results in the labour market in May, some investors expressed the slim hope that the tightening of Canadian monetary policy would begin immediately. Needless to say, these people are a bit disappointed today.

The press release accompanying the Bank of Canada decision seems to us to be quite clear: increases in key Canadian interest rates will only begin in several months. On the one hand, the Canadian economy will continue to operate below full potential over the next few quarters. On the other, despite the rise in gas prices, the Bank's forecasts regarding underlying inflation (which excludes gas) remain practically unchanged. That said, our central bank is relying on developments in underlying inflation rather than core inflation in managing its monetary policy. So, the Bank of Canada has a great deal of leeway in applying its monetary policy, which will allow it to be patient over the next few months.

Also, the speed and scope of the US Federal Reserve's repositioning of its monetary policy will determine the next upward movements in Canada. In all likelihood, the increase of US Federal Reserve rates will begin this summer, which will force the Bank of Canada to increase the cost of money in the country starting in the fall.