

# Essentials of the Monetary Policy

December 4, 2013

## **BANK OF CANADA**

**The target for the overnight rate stays at 1.00%**

**The BoC believes downside risks to inflation are more extensive**

### ACCORDING TO THE BANK OF CANADA (BoC)

- The target for the overnight rate remains at 1%.
- The global economy is expanding at a modest rate, as the BoC expected. Although growth in several emerging markets has continued to ease, growth in the United States during the third quarter of 2013 was stronger than forecast.
- In Canada, **underlying growth is broadly in line with the BoC's projections** in its October and July *Monetary Policy Reports*. Real GDP growth in the third quarter, at 2.7%, was stronger than the BoC was projecting, but its composition does not yet indicate a rebalancing towards exports and investment.
- On balance, the BoC sees no reason to adjust its expectation of a gradual return to full production capacity around the end of 2015.
- Inflation has moved further below the BoC's 2% target. Core inflation is being held down by significant excess supply and by the effects of heightened competition in the retail sector, which look to be more persistent than anticipated. In addition, total consumer price index inflation has been pushed down by lower gasoline prices.
- The risks associated with elevated household imbalances have not materially changed, while the **downside risks to inflation appear to be greater**. Overall, **the balance of risks remains within the zone articulated in October**. Weighing these considerations, the BoC judges that the substantial monetary policy stimulus currently in place remains appropriate and therefore has decided to maintain the target for the overnight rate at 1%.

### COMMENTS

As expected, the BoC has once again kept the target for the overnight rate at 1.00%. After softening their stance in October, notably by withdrawing mention of eventual hikes in key interest rates, the Canadian monetary authorities went one step further this morning, pointing out that the downside risks to inflation appeared to be more extensive. Although the BoC believes the balance of risks is still within

the zone set in October, it would appear to have moved closer to the bottom of the range, at least for inflation.

Note that in October the total annual inflation rate fell 0.7%, sliding once again below the BoC's lower target. Clearly, inflation's weakness is more persistent than expected. In the last 12 months, the total annual inflation rate dropped below the lower target six times, renewing the BoC's concerns. That said, our projections indicate that the annual inflation rate should quickly return within the target (between 1% and 3%), as certain base effects wane.

Even though growth in the third quarter was higher than the BoC's projection (2.7% instead of 1.8%), the economic outlook remains essentially unchanged. Exports are still not managing to take advantage of rebounding global demand and growth in non-residential investment continues to disappoint. The outlook for the Canadian economy without these two pillars remains very uncertain, prompting the BoC to remain cautious.

**Implications:** Given the monetary authorities' softening stance and the rather weak outlook for economic growth and inflation, the BoC could wait a little longer than expected before raising its key interest rates. Consequently, the first increase in the target for the overnight rate will most likely not be ordered before September 2015.

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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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## Schedule 2013 of Central Bank meetings

	<u>Decision</u>	<u>Rate</u>		<u>Decision</u>	<u>Rate</u>		
<b>JANUARY</b>			<b>JULY</b>				
10	European Central Bank	s.q.	0.75	2	Reserve Bank of Australia	s.q.	2.75
10	Bank of England	s.q.	0.50	3	Bank of Sweden	s.q.	1.00
16	Bank of Brazil	s.q.	7.25	4	European Central Bank	s.q.	0.50
18	Bank of Mexico	s.q.	4.50	4	Bank of England	s.q.	0.50
21	Bank of Japan	s.q.	0.10	10	Bank of Brazil	+50 b.p.	8.50
23	Bank of Canada	s.q.	1.00	11	Bank of Japan	s.q.	0.10
30	Reserve Bank of New Zealand	s.q.	2.50	12	Bank of Mexico	s.q.	4.00
30	Federal Reserve	s.q.	0.25	17	Bank of Canada	s.q.	1.00
<b>FEBRUARY</b>			<b>AUGUST</b>				
4	Reserve Bank of Australia	s.q.	3.00	1	European Central Bank	s.q.	0.50
7	European Central Bank	s.q.	0.75	1	Bank of England	s.q.	0.50
7	Bank of England	s.q.	0.50	6	Reserve Bank of Australia	-25 b.p.	2.50
13	Bank of Sweden	s.q.	1.00	8	Bank of Japan	s.q.	0.10
13	Bank of Japan	s.q.	0.10	28	Bank of Brazil	+50 b.p.	9.00
<b>MARCH</b>			<b>SEPTEMBER</b>				
4	Reserve Bank of Australia	s.q.	3.00	3	Reserve Bank of Australia	s.q.	2.50
6	Bank of Brazil	s.q.	7.25	4	Bank of Canada	s.q.	1.00
6	Bank of Canada	s.q.	1.00	5	European Central Bank	s.q.	0.50
6	Bank of Japan	s.q.	0.10	5	Bank of England	s.q.	0.50
7	European Central Bank	s.q.	0.75	5	Bank of Sweden	s.q.	1.00
7	Bank of England	s.q.	0.50	5	Bank of Japan	s.q.	0.10
8	Bank of Mexico	-50 b.p.	4.00	6	Bank of Mexico	-25 b.p.	3.75
13	Reserve Bank of New Zealand	s.q.	2.50	11	Reserve Bank of New Zealand	s.q.	2.50
14	Bank of Norway	s.q.	1.50	18	Federal Reserve	s.q.	0.25
14	Swiss National Bank	s.q.	0.00	19	Bank of Norway	s.q.	1.50
20	Federal Reserve	s.q.	0.25	19	Swiss National Bank	s.q.	0.00
<b>APRIL</b>			<b>OCTOBER</b>				
1	Reserve Bank of Australia	s.q.	3.00	1	Reserve Bank of Australia	s.q.	2.50
4	European Central Bank	s.q.	0.75	2	European Central Bank	s.q.	0.50
4	Bank of England	s.q.	0.50	4	Bank of Japan	s.q.	0.10
4	Bank of Japan	s.q.	0.10	9	Bank of Brazil	+50 b.p.	9.50
17	Bank of Sweden	s.q.	1.00	10	Bank of England	s.q.	0.50
17	Bank of Brazil	+25 b.p.	7.50	23	Bank of Canada	s.q.	1.00
17	Bank of Canada	s.q.	1.00	24	Bank of Norway	s.q.	1.50
23	Reserve Bank of New Zealand	s.q.	2.50	24	Bank of Sweden	s.q.	1.00
26	Bank of Japan	s.q.	0.10	25	Bank of Mexico	-25 b.p.	3.50
26	Bank of Mexico	s.q.	4.00	30	Reserve Bank of New Zealand	s.q.	2.50
<b>MAY</b>			<b>NOVEMBER</b>				
1	Federal Reserve	s.q.	0.25	4	Reserve Bank of Australia	s.q.	2.50
2	European Central Bank	-25 b.p.	0.50	7	European Central Bank	-25 b.p.	0.25
7	Reserve Bank of Australia	-25 b.p.	2.75	7	Bank of England	s.q.	0.50
8	Bank of Norway	s.q.	1.50	21	Bank of Japan	s.q.	0.10
9	Bank of England	s.q.	0.50	27	Bank of Brazil	+50 b.p.	10.00
22	Bank of Japan	s.q.	0.10	<b>DECEMBER</b>			
29	Bank of Brazil	+50 b.p.	8.00	2	Reserve Bank of Australia	s.q.	2.50
29	Bank of Canada	s.q.	1.00	4	Bank of Canada	s.q.	1.00
<b>JUNE</b>			<b>NOVEMBER</b>				
4	Reserve Bank of Australia	s.q.	2.75	5	European Central Bank		
6	European Central Bank	s.q.	0.50	5	Bank of England		
6	Bank of England	s.q.	0.50	5	Bank of Norway		
7	Bank of Mexico	s.q.	4.00	5	Bank of Mexico		
11	Bank of Japan	s.q.	0.10	11	Reserve Bank of New Zealand		
12	Reserve Bank of New Zealand	s.q.	2.50	12	Swiss National Bank		
19	Federal Reserve	s.q.	0.25	17	Bank of Sweden		
20	Bank of Norway	s.q.	1.50	18	Federal Reserve		
20	Swiss National Bank	s.q.	0.00	20	Bank of Japan		