

June 4, 2014

BANK OF CANADA

Inflation is recovering, but worries increase about the economy

ACCORDING TO THE BANK OF CANADA (BoC)

- The target for the overnight rate stays at 1.00%.
- Total inflation has moved up to around the 2% target, sooner than anticipated, largely due to the temporary effects of higher energy prices and exchange rate pass-through. Core inflation remains significantly below 2% although it has drifted up slightly, partly owing to past exchange rate movements.
- Global economic growth in the first quarter of 2014 was weaker than anticipated and recent developments give slightly greater weight to downside risks. The U.S. economy is rebounding after a pause in the first quarter, but there could be slightly less underlying momentum than previously expected.
- The Canadian economy grew at a modest rate in the first quarter, held back by severe weather and supply constraints. The ingredients for a pickup in exports remain in place, including the lower Canadian dollar and an anticipated strengthening of foreign demand.
- Downside risks to the inflation outlook are as important as before. At the same time, the risks associated with household imbalances remain elevated. The BoC judges that the balance of risks remains within the zone for which the current stance of monetary policy is appropriate and therefore has decided to maintain the target for the overnight rate at 1%. The timing and direction of the next change to the policy rate will depend on how new information influences the balance of risks.

COMMENTS

No one expected a major change in the BoC's stance this morning. It was thus no surprise that the target for the overnight rate stays at 1.00%, where it has stood since September 2010. The BoC also clearly pointed out that downside risk on the outlook for inflation has not changed.

Even though the BoC's overall tone was mostly unchanged, a few interesting changes should be noted in its statement. First, the BoC acknowledges that inflation continues to accelerate faster than anticipated. The annual inflation rate had already returned to 2.0% in April, even though it was

not forecast to return to the median target before 2015 in the BoC's latest *Monetary Policy Report*. Core inflation also advanced, but remained relatively weak at 1.4% in April. We note that the BoC is less insistent on core inflation than in its last statement. It must be said that our estimates show that core inflation could reach the 2.0% target by the end of the year. It is interesting to see that the BoC seems to attribute a large part of the faster-than-expected increase in inflation to depreciation in the Canadian dollar.

While the news is better on the inflation front, the BoC is more worried about the economy. First quarter Canadian growth was weaker than forecast, but the BoC notes positive factors for the future (a weaker Canadian dollar, expected firming up of foreign demand, improvement in corporate earnings). Recent growth in the global economy seems to have disappointed the BoC, however, which harbours fears that the underlying vitality of the U.S. economy is somewhat weaker.

Implications: Through this statement, the BoC confirms that its main concern is no longer the weak inflation, but the growth outlook. As long as sustained acceleration in foreign demand is unconfirmed, the BoC will continue to worry about the Canadian economy and will not consider any monetary firming, especially as it seems to be counting on a weak Canadian dollar. The key rate should therefore remain unchanged until fall 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 2014 of Central Bank meetings

	<u>Decision</u>	<u>Rate</u>
JANUARY		
9	European Central Bank	s.q.
9	Bank of England	s.q.
15	Bank of Brazil	+50 b.p.
21-22	Bank of Japan	---
22	Bank of Canada	s.q.
29	Reserve Bank of New Zealand	s.q.
29	Federal Reserve	s.q.
31	Bank of Mexico	s.q.
FEBRUARY		
3	Reserve Bank of Australia	s.q.
6	European Central Bank	s.q.
6	Bank of England	s.q.
13	Bank of Sweden	s.q.
17-18	Bank of Japan	---
26	Bank of Brazil	+25 b.p.
MARCH		
3	Reserve Bank of Australia	s.q.
5	Bank of Canada	s.q.
6	European Central Bank	s.q.
6	Bank of England	s.q.
10-11	Bank of Japan	---
12	Reserve Bank of New Zealand	+25 b.p.
19	Federal Reserve	s.q.
20	Swiss National Bank	s.q.
21	Bank of Mexico	s.q.
27	Bank of Norway	s.q.
31	Reserve Bank of Australia	s.q.
APRIL		
2	Bank of Brazil	+25 b.p.
3	European Central Bank	s.q.
7-8	Bank of Japan	---
9	Bank of Sweden	s.q.
10	Bank of England	s.q.
16	Bank of Canada	s.q.
23	Reserve Bank of New Zealand	+25 b.p.
25	Bank of Mexico	s.q.
30	Bank of Japan	---
30	Federal Reserve	s.q.
MAY		
6	Reserve Bank of Australia	s.q.
8	European Central Bank	s.q.
8	Bank of England	s.q.
8	Bank of Norway	s.q.
20-21	Bank of Japan	---
28	Bank of Brazil	s.q.
JUNE		
3	Reserve Bank of Australia	s.q.
4	Bank of Canada	s.q.
5	European Central Bank	s.q.
5	Bank of England	s.q.
6	Bank of Mexico	s.q.
11	Reserve Bank of New Zealand	s.q.
12-13	Bank of Japan	---
18	Federal Reserve	s.q.
19	Bank of Norway	s.q.
19	Swiss National Bank	s.q.

	<u>Decision</u>	<u>Rate</u>
JULY		
1	Reserve Bank of Australia	s.q.
3	European Central Bank	s.q.
3	Bank of Sweden	s.q.
10	Bank of England	s.q.
11	Bank of Mexico	s.q.
14-15	Bank of Japan	---
16	Bank of Brazil	s.q.
16	Bank of Canada	s.q.
23	Reserve Bank of New Zealand	s.q.
30	Federal Reserve	s.q.
AUGUST		
5	Reserve Bank of Australia	s.q.
7	European Central Bank	s.q.
7	Bank of England	s.q.
7-8	Bank of Japan	---
SEPTEMBER		
2	Reserve Bank of Australia	s.q.
3	Bank of Brazil	s.q.
3	Bank of Canada	s.q.
3-4	Bank of Japan	---
4	European Central Bank	s.q.
4	Bank of England	s.q.
4	Bank of Sweden	s.q.
5	Bank of Mexico	s.q.
10	Reserve Bank of New Zealand	s.q.
17	Federal Reserve	s.q.
18	Bank of Norway	s.q.
18	Swiss National Bank	s.q.
OCTOBER		
2	European Central Bank	s.q.
6	Reserve Bank of Australia	s.q.
6-7	Bank of Japan	---
9	Bank of England	s.q.
22	Bank of Canada	s.q.
23	Bank of Norway	s.q.
28	Bank of Sweden	s.q.
29	Reserve Bank of New Zealand	s.q.
29	Bank of Brazil	s.q.
29	Federal Reserve	s.q.
31	Bank of Japan	---
31	Bank of Mexico	s.q.
NOVEMBER		
3	Reserve Bank of Australia	s.q.
6	European Central Bank	s.q.
6	Bank of England	s.q.
18-19	Bank of Japan	---
DECEMBER		
1	Reserve Bank of Australia	s.q.
3	Bank of Brazil	s.q.
3	Bank of Canada	s.q.
4	European Central Bank	s.q.
4	Bank of England	s.q.
5	Bank of Mexico	s.q.
10	Reserve Bank of New Zealand	s.q.
11	Bank of Norway	s.q.
11	Swiss National Bank	s.q.
16	Bank of Sweden	s.q.
17	Federal Reserve	s.q.
18-19	Bank of Japan	---

NOTE: Certain banks may decide to change rates in-between the scheduled meetings. The abbreviations s.q. and b.p. correspond to status quo and basis points respectively.