

June 5, 2014



EUROPEAN CENTRAL BANK

Here we are: Negative interest rate and even more

ACCORDING TO THE EUROPEAN CENTRAL BANK (ECB)

- Key rates have been lowered. The interest rates on the main refinancing operations, marginal lending facility and deposit facility are 0.15%, 0.40% and -0.10% respectively.
- A series of other measures also adopted include a Targeted Longer-term Refinancing Operations program to help financial institutions grant more credit to households and businesses.
- Liquidity injected through the Securities Markets Programme (SMP) will no longer be sterilized.
- Work in preparation to buy asset-backed securities (ABS) will be intensified.
- Forecasts for economic growth in the euro zone were trimmed to 1.0% for 2014, then revised upward to 1.7% for 2015.
- The inflation forecast was revised downward to 0.7%, 1.1% and 1.4% for 2014, 2015 and 2016, respectively.

COMMENTS

Not surprisingly, the ECB took action today, announcing a negative interest rate on its deposit facility. This means that financial institutions that place their surplus liquidity in the ECB will have to pay interest rather than receive it, as is normally the case. The ECB is hoping this measure will encourage institutions stuck with a surplus to lend directly to other institutions that are lacking liquidity, and thereby kick-start activity in the interbank market.

The ECB's main challenge is still to raise the inflation rate, which is currently at 0.5%. The fact that the inflation forecast was revised downward again in June added to the urgency of taking decisive action. As such, a series of other measures was also announced today, including a program to encourage financial institutions to lend more to households and businesses. The ECB will grant long-term loans based on a financial institution's amount of credit outstanding. However, this program does not target increasing mortgage credit. A future program to purchase asset-backed securities could, however, be used to take further steps to help credit.

The ECB affirms that it is intensifying its preparatory work to implement such a program.

There was no announcement on a plan to buy sovereign bonds, but the ECB nonetheless took a step in that direction by announcing that the SMP would no longer be sterilized. Remember that this program was set up to buy sovereign bonds from struggling countries such as Greece, Spain and Ireland. At the time the program was created, the ECB decided to offset the hike in liquidity generated by this measure to avoid accusations of directly financing governments and the risk of creating too much inflation. The current context is forcing the ECB to review its old principles.

Implications: The measures announced aim to stimulate credit, kick-start the economy and accelerate inflation. But the effects will first be seen in the price of the euro. The currency had already begun to depreciate in May when the ECB rather clearly opened the door to action in June. Following today's announcements, the euro temporarily fell below US\$1.36, and we anticipate a long downward trend for the currency over the coming quarters. This adjustment needs to take place, as an increase in inflation will depend in part on the euro depreciating. The ECB could announce further measures in the coming meetings.

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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>		<u>Decision</u>	<u>Rate</u>	
JANUARY			JULY			
9	European Central Bank	s.q.	0.25	1	Reserve Bank of Australia	
9	Bank of England	s.q.	0.50	3	European Central Bank	
15	Bank of Brazil	+50 b.p.	10.50	3	Bank of Sweden	
21-22	Bank of Japan	---	---	10	Bank of England	
22	Bank of Canada	s.q.	1.00	11	Bank of Mexico	
29	Reserve Bank of New Zealand	s.q.	2.50	14-15	Bank of Japan	
29	Federal Reserve	s.q.	0.25	16	Bank of Brazil	
31	Bank of Mexico	s.q.	3.50	16	Bank of Canada	
FEBRUARY			AUGUST			
3	Reserve Bank of Australia	s.q.	2.50	5	Reserve Bank of Australia	
6	European Central Bank	s.q.	0.25	7	European Central Bank	
6	Bank of England	s.q.	0.50	7	Bank of England	
13	Bank of Sweden	s.q.	0.75	7-8	Bank of Japan	
17-18	Bank of Japan	---	---	SEPTEMBER		
26	Bank of Brazil	+25 b.p.	10.75	2	Reserve Bank of Australia	
MARCH			OCTOBER			
3	Reserve Bank of Australia	s.q.	2.50	2	European Central Bank	
5	Bank of Canada	s.q.	1.00	6	Reserve Bank of Australia	
6	European Central Bank	s.q.	0.25	6-7	Bank of Japan	
6	Bank of England	s.q.	0.50	9	Bank of England	
10-11	Bank of Japan	---	---	22	Bank of Canada	
12	Reserve Bank of New Zealand	+25 b.p.	2.75	23	Bank of Norway	
19	Federal Reserve	s.q.	0.25	28	Bank of Sweden	
20	Swiss National Bank	s.q.	0.00	29	Reserve Bank of New Zealand	
21	Bank of Mexico	s.q.	3.50	29	Bank of Brazil	
27	Bank of Norway	s.q.	1.50	29	Federal Reserve	
31	Reserve Bank of Australia	s.q.	2.50	31	Bank of Japan	
APRIL			NOVEMBER			
2	Bank of Brazil	+25 b.p.	11.00	3	Reserve Bank of Australia	
3	European Central Bank	s.q.	0.25	6	European Central Bank	
7-8	Bank of Japan	---	---	6	Bank of England	
9	Bank of Sweden	s.q.	0.75	18-19	Bank of Japan	
10	Bank of England	s.q.	0.50	DECEMBER		
16	Bank of Canada	s.q.	1.00	1	Reserve Bank of Australia	
23	Reserve Bank of New Zealand	+25 b.p.	3.00	3	Bank of Brazil	
25	Bank of Mexico	s.q.	3.50	3	Bank of Canada	
30	Bank of Japan	---	---	4	European Central Bank	
30	Federal Reserve	s.q.	0.25	4	Bank of England	
MAY			NOVEMBER			
6	Reserve Bank of Australia	s.q.	2.50	5	Bank of Mexico	
8	European Central Bank	s.q.	0.25	10	Reserve Bank of New Zealand	
8	Bank of England	s.q.	0.50	11	Bank of Norway	
8	Bank of Norway	s.q.	1.50	11	Swiss National Bank	
20-21	Bank of Japan	---	---	16	Bank of Sweden	
28	Bank of Brazil	s.q.	11.00	17	Federal Reserve	
JUNE			NOVEMBER			
3	Reserve Bank of Australia	s.q.	2.50	18-19	Bank of Japan	
4	Bank of Canada	s.q.	1.00	DECEMBER		
5	European Central Bank	-10 b.p.	0.15	1	Reserve Bank of Australia	
5	Bank of England	s.q.	0.50	3	Bank of Brazil	
6	Bank of Mexico			3	Bank of Canada	
11	Reserve Bank of New Zealand			4	European Central Bank	
12-13	Bank of Japan			4	Bank of England	
18	Federal Reserve			5	Bank of Mexico	
19	Bank of Norway			10	Reserve Bank of New Zealand	
19	Swiss National Bank			11	Bank of Norway	

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.