

Essentials of the Monetary Policy



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BANK OF CANADA

Key interest rates lowered in a surprise move

The target for the overnight rate drops from 1.00% to 0.75%

ACCORDING TO THE BANK OF CANADA (BoC)

- The target for the overnight rate decrease to 0.75%.
- This decision is in response to the recent sharp drop in oil prices, which will be negative for growth and underlying inflation in Canada.
- Oil's sharp decline in the past six months is expected to boost global economic growth, especially in the United States.
- In Canada, the oil price shock is occurring against a backdrop of solid and more broadly-based growth in recent quarters. Outside the energy sector, we are beginning to see the anticipated sequence of increased foreign demand, stronger exports, improved business confidence and investment, and employment growth. However, there is considerable uncertainty about the speed with which this sequence will evolve and how it will be affected by the drop in oil prices. Business investment in the energy-producing sector will decline. Canada's weaker terms of trade will have an adverse impact on incomes and wealth, reducing domestic demand growth.
- The BoC is projecting real GDP growth will slow to about 1.5% and the output gap to widen in the first half of 2015. The negative impact of lower oil prices will gradually be mitigated by a stronger U.S. economy, a weaker Canadian dollar, and the BoC's monetary policy response. The BoC expects Canada's economy to gradually strengthen in the second half of this year, with real GDP growth averaging 2.1% in 2015 and 2.4% in 2016.
- The economy is expected to return to full capacity around the end of 2016, a little later than was expected in October.
- Weaker oil prices will pull down the inflation profile. Total consumer price index inflation is projected to be temporarily below the inflation-control range during 2015, moving back up to target the following year. Underlying inflation will ease in the near term but then return gradually to 2% over the projection horizon.

COMMENTS

The decrease ordered today by the BoC is surprising, as all forecasters consulted by Bloomberg were expecting another status quo. Clearly, the monetary authorities were quick to act, preferring to cut down key rates as a preventive measure in an effort to mitigate the negative impact of lower gas prices on the Canadian economy. The Canadian dollar depreciated strongly in the minutes following the cut to the target for the overnight rate, losing roughly US\$1.6. It goes without saying that this downside pressure on the Canadian currency will help improve the competitive position of Canadian exports other than commodities.

In addition, uncertainties abound. On the one hand, the drop in oil prices could continue, or even intensify, in the coming months. On the other hand, the positive effects of lower oil prices, improved U.S. demand and the loonie's depreciation on consumer spending and exports other than commodities could be less pronounced than expected. The risks to the economy therefore seem further tilted to the downside.

Implications: The reduction in key interest rates will help mitigate the adverse effects of lower oil prices on the Canadian economy. Monetary authorities will most certainly like to continue down the same path at their next meeting on March 4 by ordering a second key interest rate cut. However, households' financial situation will need to be watched closely. On that front, the BoC noted in its *Monetary Policy Report* that household imbalances should increase slightly in the short term. The leeway for reducing key rates is therefore quite narrow. Under these circumstances, monetary authorities will likely return to a status quo position as of April and continue on this road until at least 2016.

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Schedule 2015 of Central Bank meetings

	<u>Decision</u>	<u>Rate</u>		<u>Decision</u>	<u>Rate</u>
JANUARY			JULY		
8	Bank of England	s.q.	0.50	1	Bank of Sweden
14	Bank of Korea	s.q.	2.00	7	Reserve Bank of Australia
15	Swiss National Bank	-50 b.p.	-0.75	9	Bank of England
20-21	Bank of Japan	---	---	9	Bank of Korea
21	Bank of Canada	-25 b.p.	0.75	15	Bank of Canada
21	Bank of Brazil			16	European Central Bank
22	European Central Bank			23	Reserve Bank of New Zealand
28	Federal Reserve			23	Bank of Mexico
29	Reserve Bank of New Zealand			29	Bank of Brazil
29	Bank of Mexico			29	Federal Reserve
				*	Bank of Japan
FEBRUARY			AUGUST		
3	Reserve Bank of Australia			6	Bank of England
5	Bank of England			4	Reserve Bank of Australia
11	Bank of Sweden			13	Bank of Korea
17	Bank of Korea			*	Bank of Japan
17-18	Bank of Japan				
MARCH			SEPTEMBER		
3	Reserve Bank of Australia			1	Reserve Bank of Australia
4	Bank of Brazil			2	Bank of Brazil
4	Bank of Canada			3	European Central Bank
5	European Central Bank			3	Bank of Mexico
5	Bank of England			9	Bank of Canada
12	Bank of Korea			10	Bank of England
12	Reserve Bank of New Zealand			10	Reserve Bank of New Zealand
16-17	Bank of Japan			11	Bank of Korea
18	Federal Reserve			17	Swiss National Bank
19	Bank of Norway			17	Federal Reserve
19	Swiss National Bank			24	Bank of Norway
26	Bank of Mexico			*	Bank of Japan
				*	Bank of Sweden
APRIL			OCTOBER		
7	Reserve Bank of Australia			6	Reserve Bank of Australia
7-8	Bank of Japan			8	Bank of England
9	Bank of England			15	Bank of Korea
9	Bank of Korea			15	Bank of Mexico
15	European Central Bank			21	Bank of Brazil
15	Bank of Canada			21	Bank of Canada
28	Bank of Sweden			22	European Central Bank
29	Bank of Brazil			28	Federal Reserve
29	Federal Reserve			29	Reserve Bank of New Zealand
30	Reserve Bank of New Zealand			*	Bank of Japan
30	Bank of Japan			*	Bank of Japan
30	Bank of Mexico			*	Bank of Sweden
MAY			NOVEMBER		
5	Reserve Bank of Australia			3	Reserve Bank of Australia
7	Bank of Norway			5	Bank of England
11	Bank of England			5	Bank of Norway
15	Bank of Korea			12	Bank of Korea
21-22	Bank of Japan			25	Bank of Brazil
27	Bank of Canada			*	Bank of Japan
JUNE			DECEMBER		
2	Reserve Bank of Australia			1	Reserve Bank of Australia
3	European Central Bank			2	Bank of Canada
3	Bank of Brazil			3	European Central Bank
4	Bank of England			3	Bank of Mexico
4	Bank of Mexico			10	Bank of England
11	Bank of Korea			10	Bank of Korea
11	Reserve Bank of New Zealand			10	Reserve Bank of New Zealand
17	Federal Reserve			10	Swiss National Bank
18	Bank of Norway			16	Federal Reserve
18	Swiss National Bank			17	Bank of Norway
18-19	Bank of Japan			*	Bank of Japan
				*	Bank of Sweden

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. * To be determined.