

March 4, 2015

## **BANK OF CANADA**

### Unless things go off the rails again, there should be no more cuts in key interest rates

### The surprise rate cut in January was enough!

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

- The target for the overnight rate stays at 0.75%.
- Canadian economic growth in the fourth quarter of 2014 was consistent with the BoC's expectations. The oil price shock had a modest early impact on aggregate demand, and a larger effect on income.
- The BoC continues to expect that most of the negative impact from lower oil prices will appear in the first half of 2015, although it may be even more front-loaded than projected in January.
- Data for 2014 as a whole suggest the anticipated rotation into stronger growth in non-energy exports and investment is well underway.
- Financial conditions in Canada have eased materially since January, in response to the BoC's recent monetary policy action and to global financial developments. This easing is reflected across the yield curve and in a wide range of asset prices, including the Canadian dollar.
- In light of these developments, the risks around the inflation profile are now more balanced and financial stability risks are evolving as expected in January.

#### COMMENTS

It was a close call, and considerable uncertainty was hanging over the BoC's decision. Forecasters were wavering between a second cut in key interest rates, and the status quo. In the end, the monetary authorities decided to keep the target for the overnight rate at 0.75%.

The recent trend in economic outlooks is pretty much in line with the latest projections put forward by the BoC in its *Monetary Policy Report* of January. Canada's real GDP grew by 2.4% in the fourth quarter, whereas the BoC was expecting growth of 2.5%. Economic growth is still expected to slow markedly in the first half of 2015 due to the negative effects of the oil price slump. Real gross domestic income (real GDI) did in fact decline by 0.7% in the fourth

quarter, which may be considered an early sign of the impact that lower oil prices will have.

Despite these hurdles, the monetary authorities seem to think that the key interest rate cut that was decreed in January, and its impact on the financial conditions prevailing in the country, will be sufficient to stimulate economic growth. It should be pointed out that some factors exist which argue against further interest rate cuts. For one, upwards pressure on core inflation is persisting, especially with the impact of the loonie's depreciation on the prices of imported goods and services. Moreover, contrary to the situation that prevailed in January, oil prices have now stabilized, and a slight increase has even been observed. Finally, the issue of financial stability is also reducing the amount of leeway for lowering interest rates further, given that household debt levels are still at record peaks. For example, the household savings rate is still low, having fallen to 3.6% in the fourth quarter.

**Implications:** Generally speaking, the BoC's economic and financial forecasts are quite similar to our projections. Today's decision to leave key interest rates unchanged shows that the BoC is confident that the current monetary conditions will be enough to enable the Canadian economy to meet the challenges that lie ahead. Therefore, the target for the overnight rate will probably remain at 0.75% until next year. On the other hand, we cannot rule out the possibility that another rate cut might be ordered in the months to come if the Canadian economy were to decelerate more than expected, or if oil prices were to start heading down again.

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## Schedule 2015 of Central Bank meetings

	<u>Decision</u>	<u>Rate</u>		<u>Decision</u>	<u>Rate</u>	
<b>JANUARY</b>			<b>JULY</b>			
8	Bank of England	s.q.	0.50	2	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 Brazil	+50 b.p.	12.25	15	Bank of Canada	
21	Bank of Canada	-25 b.p.	0.75	16	European Central Bank	
22	European Central Bank	s.q.	0.05	22	Reserve Bank of New Zealand	
28	Reserve Bank of New Zealand	s.q.	3.50	23	Bank of Mexico	
28	Federal Reserve	s.q.	0.25	29	Bank of Brazil	
29	Bank of Mexico	s.q.	3.00	29	Federal Reserve	
<b>FEBRUARY</b>			* Bank of Japan			
2	Reserve Bank of Australia	-25 b.p.	2.25	<b>AUGUST</b>		
5	Bank of England	s.q.	0.50	6	Bank of England	
12	Bank of Sweden	-10 b.p.	-0.10	4	Reserve Bank of Australia	
17	Bank of Korea	s.q.	2.00	13	Bank of Korea	
17-18	Bank of Japan	---	---	*	Bank of Japan	
<b>MARCH</b>			<b>SEPTEMBER</b>			
2	Reserve Bank of Australia	s.q.	2.25	1	Reserve Bank of Australia	
4	Bank of Canada	s.q.	0.75	2	Bank of Brazil	
4	Bank of Brazil			3	European Central Bank	
5	European Central Bank			3	Bank of Sweden	
5	Bank of England			3	Bank of Mexico	
11	Reserve Bank of New Zealand			9	Reserve Bank of New Zealand	
12	Bank of Korea			9	Bank of Canada	
16-17	Bank of Japan			10	Bank of England	
18	Federal Reserve			11	Bank of Korea	
19	Bank of Norway			17	Swiss National Bank	
19	Swiss National Bank			17	Federal Reserve	
26	Bank of Mexico			24	Bank of Norway	
<b>APRIL</b>			* Bank of Japan			
7	Reserve Bank of Australia			<b>OCTOBER</b>		
7-8	Bank of Japan			5	Reserve Bank of Australia	
9	Bank of England			8	Bank of England	
9	Bank of Korea			15	Bank of Korea	
15	European Central Bank			15	Bank of Mexico	
15	Bank of Canada			21	Bank of Brazil	
29	Reserve Bank of New Zealand			21	Bank of Canada	
29	Bank of Sweden			22	European Central Bank	
29	Bank of Brazil			28	Reserve Bank of New Zealand	
29	Federal Reserve			28	Bank of Sweden	
30	Bank of Japan			28	Federal Reserve	
30	Bank of Mexico			*	Bank of Japan	
<b>MAY</b>			* Bank of Japan			
5	Reserve Bank of Australia			<b>NOVEMBER</b>		
7	Bank of Norway			2	Reserve Bank of Australia	
11	Bank of England			5	Bank of England	
15	Bank of Korea			5	Bank of Norway	
21-22	Bank of Japan			12	Bank of Korea	
27	Bank of Canada			25	Bank of Brazil	
<b>JUNE</b>			30 Reserve Bank of Australia			
2	Reserve Bank of Australia			*	Bank of Japan	
3	European Central Bank			<b>DECEMBER</b>		
3	Bank of Brazil			2	Bank of Canada	
4	Bank of England			3	European Central Bank	
4	Bank of Mexico			3	Bank of Mexico	
10	Reserve Bank of New Zealand			9	Reserve Bank of New Zealand	
11	Bank of Korea			10	Bank of England	
17	Federal Reserve			10	Bank of Korea	
18	Bank of Norway			10	Swiss National Bank	
18	Swiss National Bank			15	Bank of Sweden	
18-19	Bank of Japan			16	Federal Reserve	
				17	Bank of Norway	
				*	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. \* To be determined.