

July 15, 2015

## **BANK OF CANADA**

### New decrease in key rates

### The Bank of Canada expects a short technical recession

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

- The target for the overnight rate drops from 0.75% to 0.50%.
- Total CPI inflation in Canada has been around 1% in recent months, reflecting year-over-year price declines for consumer energy products. Core inflation has been close to 2%, with disinflationary pressures from economic slack being offset by transitory effects of the past depreciation of the Canadian dollar and some sector-specific factors.
- Global growth faltered in early 2015, principally in the United States and China. Recent indicators suggest a rebound in the U.S. economy in the second half of this year, and growth is expected to be solid through the projection.
- The BoC's estimate of growth in Canada in 2015 has been marked down considerably from its April projection. The downward revision reflects further downgrades of business investment plans in the energy sector, as well as weaker-than-expected exports of non-energy commodities and non-commodities.
- The BoC now projects Canada's real GDP will grow by just over 1.0% in 2015 and about 2.5% in 2016 and 2017. With this revised growth profile, the output gap is significantly larger than was expected in April, and closes somewhat later. The BoC anticipates that the economy will return to full capacity and inflation to 2% on a sustained basis in the first half of 2017.

#### COMMENTS

As predicted by a slight majority of analysts, the BoC announced a 0.25% decrease in key rates this morning. After falling to 0.75% last January, the target for the overnight rate slipped to 0.50%, just a quarter percentage point above its historic low in 2009.

As Canadian inflation is progressing as expected, today's monetary softening stems directly from the Canadian economy's very disappointing performance. Far from rebounding, the Canadian economy continued to struggle in the spring, and the BoC now predicts a contraction of around 0.5% of real GDP in the second quarter. Such

a scenario, which is similar to our own expectations, confirms that the Canadian economy has entered a technical recession. However, this pullback over two quarters will be concentrated in energy-dependent sectors and provinces.

The greater than expected difficulties for the Canadian economy are explained by the pronounced impacts of falling energy prices on business investment as well as disappointing progress in non-energy goods exports. The BoC therefore had to revise its forecast for economic growth for 2015 sharply downward. This increases the output gap in Canada and poses additional downside risks on the outlook for inflation, which explains this morning's monetary softening.

Even though the BoC is now expecting a technical recession, it remains optimistic about the future. It notes that consumer confidence is high outside of oil-producing provinces, that manufacturing activity is showing signs of a recovery and that the labour market is doing fairly well. The U.S. economy's good performance should also be a boon for Canadian exports.

**Implications:** Similarly to what happened in January, this morning's decrease in key rates should be followed by a period of status quo while the BoC considers the effect of its decision. If the Canadian economy recovers in the second half of 2015, as the BoC and we predict, the next movement in key rates could be an increase, but only at the end of 2016 or beginning of 2017.

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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	-10 b.p.	-0.35
14	Bank of Korea	s.q.	2.00	7	Reserve Bank of Australia	s.q.	2.00
15	Swiss National Bank	-50 b.p.	-0.75	8	Bank of Korea		1.50
20-21	Bank of Japan	---	---	9	Bank of England	s.q.	0.50
21	Bank of Brazil	+50 b.p.	12.25	14-15	Bank of Japan	---	---
21	Bank of Canada	-25 b.p.	0.75	15	Bank of Canada	-25 b.p.	0.50
22	European Central Bank	s.q.	0.05	16	European Central Bank		
28	Reserve Bank of New Zealand	s.q.	3.50	22	Reserve Bank of New Zealand		
28	Federal Reserve	s.q.	0.25	23	Bank of Mexico		
29	Bank of Mexico	s.q.	3.00	29	Bank of Brazil		
<b>FEBRUARY</b>			<b>AUGUST</b>				
2	Reserve Bank of Australia	-25 b.p.	2.25	4	Reserve Bank of Australia		
5	Bank of England	s.q.	0.50	6	Bank of England		
12	Bank of Sweden	-10 b.p.	-0.10	6-7	Bank of Japan		
16	Bank of Korea	s.q.	2.00	12	Bank of Korea		
17-18	Bank of Japan	---	---	<b>SEPTEMBER</b>			
<b>MARCH</b>			<b>SEPTEMBER</b>				
2	Reserve Bank of Australia	s.q.	2.25	1	Reserve Bank of Australia		
4	Bank of Brazil	+50 b.p.	12.75	2	Bank of Brazil		
4	Bank of Canada	s.q.	0.75	3	European Central Bank		
5	European Central Bank	s.q.	0.05	3	Bank of Sweden		
5	Bank of England	s.q.	0.50	3	Bank of Mexico		
11	Bank of Korea	-25 b.p.	1.75	9	Reserve Bank of New Zealand		
11	Reserve Bank of New Zealand	s.q.	3.50	9	Bank of Canada		
16-17	Bank of Japan	---	---	10	Bank of England		
18	Bank of Sweden	-15 b.p.	-0.25	11	Bank of Korea		
18	Federal Reserve	s.q.	0.25	14-15	Bank of Japan		
19	Bank of Norway	s.q.	1.25	17	Swiss National Bank		
19	Swiss National Bank	s.q.	-0.75	17	Federal Reserve		
26	Bank of Mexico	s.q.	3.00	24	Bank of Norway		
<b>APRIL</b>			<b>OCTOBER</b>				
7	Reserve Bank of Australia	s.q.	2.25	5	Reserve Bank of Australia		
7-8	Bank of Japan	---	---	6-7	Bank of Japan		
9	Bank of England	s.q.	0.50	8	Bank of England		
9	Bank of Korea	s.q.	1.75	14	Bank of Korea		
15	European Central Bank	s.q.	0.05	15	Bank of Mexico		
15	Bank of Canada	s.q.	0.75	21	Bank of Brazil		
29	Reserve Bank of New Zealand	s.q.	3.50	21	Bank of Canada		
29	Bank of Sweden	s.q.	-0.25	22	European Central Bank		
29	Bank of Brazil	+50 b.p.	13.25	28	Reserve Bank of New Zealand		
29	Federal Reserve	s.q.	0.25	28	Bank of Sweden		
30	Bank of Japan	---	---	28	Federal Reserve		
30	Bank of Mexico	s.q.	3.00	30	Bank of Japan		
<b>MAY</b>			<b>NOVEMBER</b>				
5	Reserve Bank of Australia	-25 b.p.	2.00	2	Reserve Bank of Australia		
7	Bank of Norway	s.q.	1.25	5	Bank of England		
11	Bank of England	s.q.	0.50	5	Bank of Norway		
15	Bank of Korea	s.q.	1.75	11	Bank of Korea		
21-22	Bank of Japan	---	---	18-19	Bank of Japan		
27	Bank of Canada	s.q.	0.75	25	Bank of Brazil		
<b>JUNE</b>			<b>NOVEMBER</b>				
2	Reserve Bank of Australia	s.q.	2.00	30	Reserve Bank of Australia		
3	European Central Bank	s.q.	0.05	<b>DECEMBER</b>			
3	Bank of Brazil	+50 b.p.	13.75	2	Bank of Canada		
4	Bank of England	s.q.	0.50	3	European Central Bank		
4	Bank of Mexico	s.q.	3.00	3	Bank of Mexico		
10	Bank of Korea	-25 b.p.	1.50	9	Bank of Korea		
10	Reserve Bank of New Zealand	-25 b.p.	3.25	9	Reserve Bank of New Zealand		
17	Federal Reserve	s.q.	0.25	10	Bank of England		
18	Bank of Norway	-25 b.p.	1.00	9	Bank of Korea		
18	Swiss National Bank	s.q.	-0.75	10	Swiss National Bank		
18-19	Bank of Japan	---	---	15	Bank of Sweden		
				16	Federal Reserve		
				17	Bank of Norway		
				17-18	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.