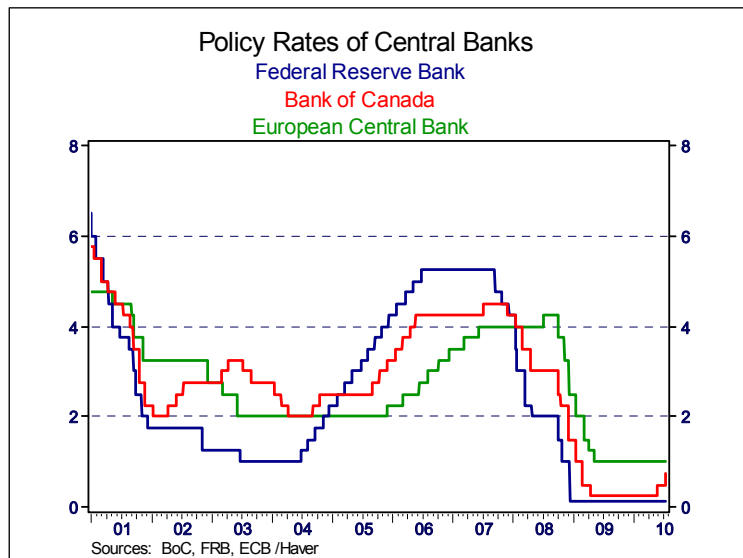




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The higher the key rate goes, the more difficult raising it will become



A modest increase of 25 basis points this morning, with no guarantees as to the future: Bank of Canada leaders came to this conclusion today.

Although we agree that all decisions are weighed carefully, the fact remains that today's decision was a fairly easy one. Raising the key rate from 0.50% to 0.75% is not very risky, as Governor Carney must tell himself that he won't take a step backward—the key rate will probably not go back to 0.50% or even 0.25%. Here, in our opinion, the likeliest scenario is another quarter-point increase to 1.00% on September 8, even if there is nothing certain according to our central bank: *“Given the considerable uncertainty surrounding the outlook, any further reduction of monetary stimulus would have to be weighed carefully against domestic and global economic developments.”*

The September, October and December decisions promise to be increasingly delicate, especially in a context in which

the future of the economic recovery is uncertain. The Bank of Canada has maintained the same tone as on June 1 because it has not substantially shifted its economic projections. As the Federal Reserve lowered its real GDP projections last week, we cannot be surprised that the Bank of Canada followed suit here today: a growth of 3.5% for 2010 and 2.9% for 2011 are anticipated, barely two tenths of a point lower than last April's projections. This modest adjustment *“reflects a slightly weaker profile for global economic growth and more modest consumption growth in Canada.”*

The Bank of Canada will eventually stop removing some monetary stimulus; it is just very difficult to pinpoint the timing. In our opinion, once it initiates a pause it will stay on the sidelines for several months until credit, inflation and hiring are back in the United States. In fact, if there was any surprise in the statement, it was that the Bank of Canada did not spotlight the worsening slowdown in the United States, as we had expected. The American economy, our first trade partner, seems to be losing altitude almost every day. Perhaps the Bank of Canada thought it would simply be better to say more about it on Thursday when it will release its *Monetary Policy Report*.

All in all, the easiest decisions have been made. As the key rate closes in on 1%, it will be more and more difficult to raise it in the context of the current slowdown. As a result, there is a slight downside risk to our year-end forecast (1.50%). Lastly, looking further ahead, it is hard to see how the key rate could reach 2.50%-3.50% at the end of 2011 if the economy only expands by 2.2% in 2012, as the Bank of Canada is projecting, even if inflation will be close to the target.

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