

Economic Commentary

July 20, 2004

Bank of Canada Maintains Target for the Overnight Interest Rate at 2.0 %

The Bank of Canada announced this morning that it is maintaining its target for the overnight money rate at 2 per cent. The Bank's outlook for the Canadian economy was little changed from the April Monetary Policy Report. The economy is judged to be operating slightly closer to full capacity than it had in April and the central bank expects that production will reach full capacity by mid-2004 instead of end of 2004. Core inflation is still projected to move up to 2.0% by the end of 2005, it presently stands at 1.7%. However, the short-term projection has been raised slightly to account for slightly higher than anticipated energy prices.

Although the Bank's decision was universally expected by market participants, the market also expected some reference to the need to tighten interest rates in the near term which was not included in its press release. This leaves interest rate anticipations more uncertain than they were going into the Bank's decision this morning. In recent weeks, given the strength in Canada's economy the market has been gearing up for a September 8th quarter point rate hike. As a result, the Canadian dollar sold off some of its recent gains this morning falling by almost 1 per cent against its US counterpart, leaving it at this moment at USD \$0.7550.

More clues as to the central bank's next move should come Thursday morning when it releases its latest monetary policy report. Right now, the Bank of Canada's stance stands at odds with the direction of monetary policy in the USA, where the Fed made its first quarter point rate hike on June 30th. This afternoon, Fed Chairman Alan Greenspan will give his semi-annual testimony to the Senate Banking Committee and might provide further clues as to how fast or how gradually the Fed intends to raise rates in the USA.

Kenneth Matziorinis, Ph.D.
Canbek Economic Consultants Inc.