

Economic Commentary

May 29, 2001

Bank of Canada Goes For 1/4 Point Cut

This morning the BOC announced a quarter point reduction in the bank rate to 4.75%. The Bank cited concern about continued weakness in the US economy but also the need to apply some pressure on inflation. In effect, the Bank is betting that momentum and tax cuts in Canada will continue to insulate Canada from recessionary forces in the USA. I would say a brave assumption.

The risk with this decision is that continued weakness south of the border and globally will continue to act as a drag on Canada's economy, and any further relief down the road will prove too little to late. The Canadian dollar will not be helped very much by this stance but the risks that it will be slammed down the road have increased. Either David Dodge knows something we do not know or he is too new on the job.

Canada's chartered banks are expected to match the rate cut with a quarter point cut of their own in the prime lending rate to 6.25%.

The FOMC meets on the 26-27 of June and is widely expected to cut the fed funds rate another quarter point to 3.75%, while the next regularly scheduled meeting of the BOC is slated for July 17, 2001. I expect another quarter point cut at that point, which will bring the Canadian prime down to 6.0%.

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