

Economic Commentary

September 4, 2003

ECB to Hold Rates the Same at 2.0%, BOE to do the Same at 3.5%

The Central councils of the European Central Bank and the Bank of England are meeting today and they are expected to keep rates unchanged. The European economies have been showing signs of economic recovery in recent months helped by the pull back in the euro which has come down to 1.09 from 1.19 at the end of May (down 9% from its high) and the historically low short term interest rate which now stands at 2% for the euro-zone (3.5% for Britain, the lowest since 1955). The ECB governing council's meeting today will be chaired by Lucas Papademos, ex-Governor of the Bank of Greece.

Yesterday the Bank of Canada did the expected and lowered the overnight rate by 0.25 points to 2.75%. As expected, the decision also helped the Canadian dollar, which rose 1.0% during the day against the greenback. The Bank of Canada's next rate announcement will take place on October 15th. Canadian overnight rate now stand 175 basis points above the US fed funds rate. For the press release issued by the Bank of Canada explaining yesterday's decision, read below:

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FOR IMMEDIATE RELEASE 3 September 2003
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Bank of Canada lowers target for the overnight rate by 1/4 percentage point to 2 3/4 per cent OTTAWA - The Bank of Canada today announced that it is lowering its target for the overnight rate by one-quarter of one percentage point to 2 3/4 per cent. The operating band for the overnight rate is correspondingly lowered, and the Bank Rate is now 3 per cent. Since the Bank's last interest rate announcement on 15 July, inflation pressures have continued to ease. Core inflation has declined below the 2 per cent inflation target earlier than the Bank anticipated, and it appears that lower inflation will persist over the coming months. As expected, economic growth was interrupted in the second quarter of the year, and the pace of growth in the third quarter will likely remain below potential. This recent weakness reflects the impact of a number of near-term factors such as severe acute respiratory syndrome (SARS), the effect of an isolated case of bovine spongiform encephalopathy (BSE) on exports of Canadian beef and cattle, the power blackout in Ontario, and the forest fires in Western Canada. Notwithstanding these developments, there are clear indications that conditions are in place for a strengthening of economic

growth. Final domestic demand growth has remained robust and the adverse effects of the near-term factors are beginning to dissipate. The economic rebound in the United States began earlier, and will be stronger, than previously expected. As well, the tone of capital markets remains favourable. Overall, despite current weakness, the accumulation of economic evidence to date reinforces the Bank's view that growth in the Canadian economy will strengthen towards the end of 2003 and through 2004. With today's decision, policy interest rates will support the return to levels of economic activity consistent with achieving an overall balance of aggregate demand and supply and thus keeping inflation near the target over the medium term. Information note: The Bank of Canada's next scheduled date for announcing the overnight rate target is 15 October 2003. The Monetary Policy Report will be published on 22 October 2003.