Economic Commentary

June 8, 2004

The Bank of Canada Keeps Target Overnight Rate Unchanged at 2.0%

The Bank of Canada announced today that it is maintaining its target for the overnight money rate at 2%. The decision was fully anticipated so it comes as no surprise to the markets. In the statement that accompanied last meeting's decision to cut the rate on April 13th, the Bank made it known back then that "the risks to the outlook now appear balanced" which is about as close as the Bank will ever come to openly declaring that it has come to the end of the current rate cutting cycle.

Now that it is clearly apparent that the Bank has finished cutting interest rates, the attention of economic analysts and market traders has turned to the question of when will the next interest rate hike come. With solid growth coming from the United States and the global economy, and with the recent slew of good economic news on GDP and employment that came out of Canada the past week, the expectation is that rates have nowhere to go from here but up with the only remaining question being, when.

At this moment markets are expecting the central bank to stand pat at the July 20th meeting, but make its move at the September 8th meeting. Markets are currently pricing a 25 basis point rise in rates in September contracts. My view is that we will see rate increases perhaps as early as at the September 8th meeting, but most probably later in the year at either the October 19th or December 7th meetings. It is still premature at this point to try to make any precise predictions about the date of the next rate hike since much depends on the course of economic growth, employment growth, inflation and the Feds decisions, which along with the usual factors also have to take into account the US presidential election.

Thus, make the best of the low rates we have right now but start planning for the inevitable, a gradual rise in rates starting at the latter part of this year.

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