

April 16, 2014

## **BANK OF CANADA**

### Inflation will return soon near its 2% target

#### ACCORDING TO THE BANK OF CANADA (BoC)

- The target for the overnight rate stays at 1.00%.
- The economic recovery in the United States appears to be on track, despite soft readings in the last few months largely due to unusual weather. Overall, global growth is expected to pick up to 3.3 per cent in 2014 and increase further to 3.7 per cent in 2015 and 2016.
- Canada's real GDP growth should average about 2.5 per cent in 2014 and 2015 before easing to around the 2 per cent growth rate of the economy's potential in 2016. Competitiveness challenges continue to weigh on Canadian exporters' ability to benefit from stronger growth abroad. However, a range of export subsectors have been growing in line with fundamentals, which suggests that as the U.S. recovery gathers momentum and becomes more broadly-based, many of our exports will benefit.
- Core inflation is expected to stay well below 2 per cent this year due to the effects of economic slack and heightened retail competition, and these effects will persist until early 2016. However, higher consumer energy prices and the lower Canadian dollar will exert temporary upward pressure on total CPI inflation, pushing it closer to the 2 per cent target in the coming quarters.
- With underlying inflation expected to remain below target for some time, the downside risks to inflation remain important. At the same time, the risks associated with household imbalances remain elevated. The timing and direction of the next change to the policy rate will depend on how new information influences the balance of risks.

#### COMMENTS

It comes as no surprise that the BoC has had to revise its economic scenarios compared to its January outlook. The particularly harsh winter resulted in weaker advances in activity in the first quarter, in both the United States and in Canada, leading the BoC to trim its growth projections in both countries for 2014 overall.

Besides the weather-related effects, the outlooks for growth have barely changed, and the BoC even appears more upbeat on some major aspects of the economy. On the U.S. side,

the BoC notes that private demand could beat expectations. On this side of the border, the BoC's statement no longer refers to the disappointing state of exports. Instead, it states that despite the challenges of lagging competitiveness, the solid performance in several export subsectors lends hope of a broader acceleration. In addition, despite the lacklustre start to the year, the excess supply in Canada's economy is slightly weaker than the BoC's estimate in January.

The biggest changes involve inflation. The BoC's outlooks on inflation confirm that the period of very weak inflation—which prompted the monetary authorities to change their tone last fall—is drawing to a close. After reaching 0.9% in the last quarter of 2013, total inflation will reach 1.6% in Q2 and be close to its 2.0% target in the second half of 2014, or about three quarters earlier than the BoC had projected in January. The BoC is asserting, however, that core inflation will remain below target for some time.

**Implications:** By putting the emphasis on core inflation in its statement, the BoC has succeeded in maintaining its relatively dovish tone and not completely shutting the door to a cut in key rates. That said, nothing would justify such a move now that exports are showing more encouraging signs. Everything suggests that Canadian key rates will remain unchanged for several more quarters—and the next move will be an increase.

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NOTE TO READERS: The letters **k**, **M** and **B** are used in texts and tables to refer to thousands, millions and billions respectively.

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## Schedule 2014 of Central Bank meetings

	<u>Decision</u>	<u>Rate</u>		<u>Decision</u>	<u>Rate</u>	
<b>JANUARY</b>			<b>JULY</b>			
9	European Central Bank	s.q.	0.25	1	Reserve Bank of Australia	
9	Bank of England	s.q.	0.50	3	European Central Bank	
15	Bank of Brazil	+50 b.p.	10.50	3	Bank of Sweden	
21-22	Bank of Japan	---	---	10	Bank of England	
22	Bank of Canada	s.q.	1.00	11	Bank of Mexico	
29	Reserve Bank of New Zealand	s.q.	2.50	14-15	Bank of Japan	
29	Federal Reserve	s.q.	0.25	16	Bank of Brazil	
31	Bank of Mexico	s.q.	3.50	16	Bank of Canada	
<b>FEBRUARY</b>			<b>AUGUST</b>			
3	Reserve Bank of Australia	s.q.	2.50	5	Reserve Bank of Australia	
6	European Central Bank	s.q.	0.25	7	European Central Bank	
6	Bank of England	s.q.	0.50	7	Bank of England	
13	Bank of Sweden	s.q.	0.75	7-8	Bank of Japan	
17-18	Bank of Japan	---	---	<b>SEPTEMBER</b>		
26	Bank of Brazil	+25 b.p.	10.75	2	Reserve Bank of Australia	
<b>MARCH</b>			<b>OCTOBER</b>			
3	Reserve Bank of Australia	s.q.	2.50	2	European Central Bank	
5	Bank of Canada	s.q.	1.00	6	Reserve Bank of Australia	
6	European Central Bank	s.q.	0.25	6-7	Bank of Japan	
6	Bank of England	s.q.	0.50	9	Bank of England	
10-11	Bank of Japan	---	---	22	Bank of Canada	
12	Reserve Bank of New Zealand	+25 b.p.	2.75	23	Bank of Norway	
19	Federal Reserve	s.q.	0.25	28	Bank of Sweden	
20	Swiss National Bank	s.q.	0.00	29	Reserve Bank of New Zealand	
21	Bank of Mexico	s.q.	3.50	29	Bank of Brazil	
27	Bank of Norway	s.q.	1.50	29	Federal Reserve	
31	Reserve Bank of Australia	s.q.	2.50	31	Bank of Japan	
<b>APRIL</b>			<b>NOVEMBER</b>			
2	Bank of Brazil	+25 b.p.	11.00	3	Reserve Bank of Australia	
3	European Central Bank	s.q.	0.25	6	European Central Bank	
7-8	Bank of Japan	---	---	6	Bank of England	
9	Bank of Sweden	s.q.	0.75	18-19	Bank of Japan	
10	Bank of England	s.q.	0.50	<b>DECEMBER</b>		
16	Bank of Canada	s.q.	1.00	1	Reserve Bank of Australia	
23	Reserve Bank of New Zealand			3	Bank of Brazil	
25	Bank of Mexico			3	Bank of Canada	
30	Bank of Japan			4	European Central Bank	
30	Federal Reserve			4	Bank of England	
<b>MAY</b>			<b>NOVEMBER</b>			
6	Reserve Bank of Australia			5	Bank of Mexico	
8	European Central Bank			10	Reserve Bank of New Zealand	
8	Bank of England			11	Bank of Norway	
8	Bank of Norway			11	Swiss National Bank	
20-21	Bank of Japan			16	Bank of Sweden	
28	Bank of Brazil			17	Federal Reserve	
<b>JUNE</b>			<b>NOVEMBER</b>			
3	Reserve Bank of Australia			18-19	Bank of Japan	
4	Bank of Canada			<b>DECEMBER</b>		
5	European Central Bank			1	Reserve Bank of Australia	
5	Bank of England			3	Bank of Brazil	
6	Bank of Mexico			3	Bank of Canada	
11	Reserve Bank of New Zealand			4	European Central Bank	
12-13	Bank of Japan			4	Bank of England	
18	Federal Reserve			5	Bank of Mexico	
19	Bank of Norway			10	Reserve Bank of New Zealand	
19	Swiss National Bank			11	Bank of Norway	

NOTE: Certain banks may decide to change rates in-between the scheduled meetings. The abbreviations s.q. and b.p. correspond to status quo and basis points respectively.