



TD Economics

Commentary

October 8, 2008

GLOBAL EASING IN MONETARY POLICY

- **Central banks across industrialized world cut rates by half a percentage point**
- **Further easing to come, with Fed and Bank of Canada to cut 50 basis points later this month**
- **More extensive rate cuts likely in Europe**

In a surprise decision, central banks in the industrialized world announced a coordinated half percentage point easing in monetary policy this morning. The message from all of the central banks was loud and clear: the prospects of significantly slower global growth mean that global inflation risks are dead. The coordination and the rate change between regular meetings also infer the urgency of action and the need to restore confidence to the global financial system in the wake of unprecedented turmoil.

In terms of the details, the U.S. Federal Reserve, Bank of Canada (BoC), European Central Bank (ECB), Bank of England (BoE), Sweden's Riksbank and Swiss National Bank all cut rates – while the Bank of Japan left rates unchanged at their currently low 0.5% but provided a communiqué to markets supporting the decision of the other monetary authorities. Today's actions lower the Fed funds rate to 1.50%, the BoC overnight rate to 2.50%, the ECB refinance rate to 3.75%, and the BoE repo rate to 4.50%. In evidence of the global nature of the easing, China also cut rates today to 6.93%.

The central banks issued statements that began with common wording, but then provided local details. The key common statement was that “Inflation expectations are diminishing...the financial crisis has augmented the downside risks to growth and thus has diminished further upside risk to price stability.” In the local details, the Fed noted that “economic activity has slowed markedly...the intensification of the financial market turmoil is likely to

exert additional restraint on spending partly by reducing the ability to obtain credit.” The Bank of Canada highlighted that a weaker US economy would dampen Canadian exports and this would act to moderate growth in domestic demand. The decline in the Canadian dollar would only be a partial offset and the weakening in demand and lower commodity prices will lower inflation.

This leads to the fundamental question of whether today's actions were needed: the answer is ‘Yes’. As we expressed in our Quarterly Economic Forecast (available at www.td.com/economics) the global economy is headed for at least a mild recession. Since the start of the year, the forecasts of the various monetary authorities all predicted significant economic improvement in late 2008 and 2009, which we felt was highly unlikely. Moreover, we repeatedly stressed that the worries about inflation were unfounded, as weakening demand and a correction in commodity prices would eventually address any price pressures. What TD Economics did not anticipate was the depths of the financial turmoil that has recently unfolded, and that poses downside risks to our already conservative economic forecasts.

So, an easing in monetary policy was called for, and it was needed on a global basis. Moreover, further rate cuts are in the pipeline. We look for the Fed and the BoC to cut by a further 50 basis points at their upcoming rate announcements on October 29 and Oct 21, respectively. The ECB and the BoE likely have even greater easing to deliver in the months head, and we anticipate a cumulative 125 basis points from the former and 150 basis points from the latter. For more details on the interest rate outlook, please refer to the TD Economics Global Markets publication that will be released tomorrow morning.

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