



**Bank  
Financial  
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# TD Economics

## Commentary

April 22, 2008

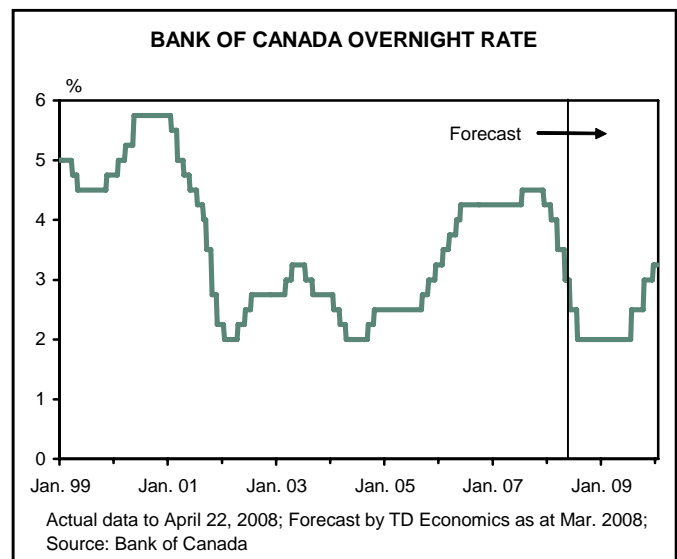
### BANK OF CANADA CUTS 0.50%: AN OUNCE OF PREVENTION TO AVERT A WORLD OF HURT

- Overnight target rate lowered 50bps to 3.00%
- Buoyant domestic demand, but worsening trade and credit conditions

For the second time in a row, the Bank of Canada has cut the overnight rate by 50bps, bringing the target rate to 3.00%. This is now the first time since 2001 – when Canada was last concerned about the fallout from a U.S. recession – that the Bank has seen fit to cut rates by a full percentage point in just six weeks time. While the latest statistics have underscored a resurgent strength in Canadian home construction, manufacturing, and international trade, the Bank is looking past these red herrings and has their sights set squarely on the formidable risks looming over the horizon.

In their communiqué, the Bank noted that “buoyant growth in domestic demand...has been substantially offset by the fall in net exports.” Due to a “deeper and more protracted slowdown in the U.S. economy,” this drag from trade is expected to remain. And, in spite of financial conditions exacerbating these problems somewhat, the low level of unemployment and aggressive easing from the Bank to date highlights why many Canadians have remained fairly sheltered from the U.S. and financial-centred woes. But, the Bank now forecasts the Canadian economy will expand by 1.4% in 2008 (down from 1.8%) and 2.4% in 2009 (down from 2.8%). Moreover, with spare capacity expected to swell into 2009, the Bank sees inflation – now running below 1.5% by both the core and headline measures – not returning to its 2% target until 2010.

On Thursday, the Bank will release their updated Monetary Policy Report. Based on this communiqué and recent statements, we expect the Bank to report dramatically lower expectations for U.S. and global growth compared with their January forecasts. Moreover, the Bank’s



Business Outlook Survey (BOS) for Spring 2008 released last week showed firms’ declining expectations for future sales growth and investment spending, as well as a falling and below average share of firms reporting shortages of labour. The BOS also confirmed that the availability of credit remains as bad as it was last summer. Through its aggressive cuts and liquidity injections, the Bank hopes to ease these pressures. Lower rates will help shield the economy from externally-driven weaknesses, but the imbalances in the financial sector continue to impair short-term borrowing.

The Bank’s statement for “some further monetary stimulus” in the future may be a bit softer. However, the Bank’s forecast for Canadian economic growth in 2008 and 2009 still seems optimistic. Therefore, we continue to think that another 50bps cut at the next meeting on June 10<sup>th</sup> would be warranted given the balance of risks to the economy.

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