

BoC slashes interest rates

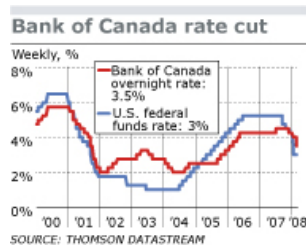
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OTTAWA — The Bank of Canada dropped its key lending rate by half a percentage point, and indicated that further cuts will be needed to insulate Canada from the effects of a U.S. economy on the brink of recession.

“The deterioration in economic and financial conditions in the United States can be expected to have significant spillover effects on the global economy,” the central bank said in its statement Tuesday.

“Further monetary stimulus is likely to be required in the near term to keep aggregate supply and demand in balance and to achieve the 2 per cent inflation target over the medium term”, the bank said.

Mark Carney's first policy decision as governor left the Bank of Canada's benchmark interest rate at 3.5 per cent, the lowest in two years. The central bank last reduced borrowing costs by a half point in November 2001 and has adjusted interest rates by that magnitude only four times since moving to a fixed announcement schedule in March 2000.



The Bank of Canada dropped its key lending rate by half a percentage point to 3.5 per cent on Tuesday.

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Bank cuts rates

The Bank of Canada cut its key rate by half a percentage point on Tuesday

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Mr. Carney and his five deputies on the Governing Council next fix interest rates on April 22.

The central bank's decision to get more aggressive after quarter-point reductions in December and January shows policy makers doubt Canada's still buoyant domestic economy will hold up in the face of weaker demand from the country's largest trading partner.

Canada's gross domestic product grew 0.8 per cent in the fourth quarter, the slowest in 4½ years and half as much as the Bank of Canada was expecting. The U.S. economy, which consumes some 80 per cent of Canada's exports, was even weaker in the fourth quarter, advancing at a 0.6 per cent annual rate.

“The dominant theme is that Canada cannot escape the fallout from the U.S. economic slump, which has contributed to the strength in the Canadian dollar and has led to weaker demand for Canadian exports,” Craig Alexander, deputy chief economist at Toronto-Dominion Bank, said in an analysis of the Bank of Canada’s rate decision.

The central bank in its statement said the world’s largest economy was crumbling faster than officials expected less than two months ago.

“There are clear signs the U.S. economy is likely to experience a deeper and more prolonged slowdown than had been projected in January,” the central bank said in the statement, citing the housing market, which is suffering the biggest collapse in generation. “These developments suggest that important downside risks to Canada’s economic outlook that were identified in (January) are materializing and, in some respects, intensifying.”

Canada’s overnight rate for loans between commercial banks — the Bank of Canada’s benchmark — is now a half point higher than the similar rate charge by the U.S. Federal Reserve.

The gap between the two official rates was the largest in since June 2004 before today’s decision, making Canadian interest-bearing assets more attractive and fueling demand for the country’s currency that’s already inflated by record commodity prices.

Canada’s dollar had weakened 0.3 per cent against its U.S. counterpart to just above parity by about 11 a.m. (ET), according to Bloomberg News.

The Federal Reserve is expected to lower U.S. borrowing costs again on March 18.

The Bank of England and the European Central Bank announce their next policy decisions in two days, and economists expect the institutions to leave their key interest rates unchanged because of worries over inflation, according to Bloomberg.

Australia’s central bank raised its benchmark interest rate a quarter point today to 7.25 per cent to cool the fastest price increases in 12 years.

While conceding that Canada’s domestic demand remains “buoyant” and that companies were producing above capacity, policy makers determined the bigger worry is economy won’t generate enough activity to keep inflation at its 2 per cent target.

“The bank now judges that the balance of risks around its January projection for inflation has clearly shifted to the downside,” the central bank said in its statement.

The Bank of Canada sets interest rates to keep inflation advancing at about 2 per cent a year, and uses a measure that strips out volatile prices such as energy to predict where costs are heading.

Canada’s core rate of inflation was 1.4 per cent, leaving plenty of room for today’s half-point cut, economists said before the announcement.

“The Bank of Canada is deferring to growth,” said Stewart Hall, a market strategist at HSBC in Toronto. “Why aren’t we as concerned about inflation? Because the numbers tell us we don’t have to be.”

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