Bank of Canada cuts key interest rate to 0.25%

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The Bank of Canada on Tuesday lowered a key lending rate again as the central bank reduced its economic outlook for 2009 and 2010.
The bank reduced the overnight rate by one-quarter of a percentage point to 0.25 per cent, which the bank said is the lowest effective rate. The lending rate will remain at the level until the middle of 2010 depending on inflation rates as the Bank of Canada tries to get the economy moving.

Signalling that it plans to put the trend-setting rate on hold for more than a year is an unprecedented move for the central bank, said TD Bank economist Don Drummond.

"I think it's unprecedented anywhere in the world," Drummond said. "We can't find any central bank who has ever done anything like that."

The Bank of Canada also threw out its January forecast that predicted a contraction of 1.2 per cent this year, followed by growth of 3.8 per cent next year.

The bank now says the recession in Canada will be deeper than anticipated, with the economy projected to contract by 3.0 per cent in 2009. The bank now expects the recovery to be delayed until the fourth quarter and to be more gradual.

The bank's new forecast sees the economy growing by 2.5 per cent in 2010 and 4.7 per cent in 2011.

"In an environment of continued high uncertainty, the global recession has intensified and become more synchronous since the bank's January monetary policy report update, with weaker-than-expected activity in all major economies," the bank said in Tuesday's announcement.

"Deteriorating credit conditions have spread quickly through trade, financial, and confidence channels," the bank said, adding that measures taken by the G20 to bolster the global financial system have taken longer to enact than expected.

On Thursday, the bank will provide more details on its view for the economy when it releases its next monetary policy report.

On the inflation front, the bank sees core inflation diminishing through 2009, before gradually returning to the bank's two per cent target in the third quarter of 2011. Overall consumer price index inflation is expected to bottom out at -0.8 per cent in the third quarter of 2009 before rebounding.

In the wake of the central bank's decision to cut lending rates, Canada 's major banks quickly moved to lower their prime rates what they charge their top customers by one-quarter of a percentage point to 2.25 per cent.

With the bank having exhausted its options on rate cutting, economists are looking to see what the central bank's next steps will be when it comes to stimulating the economy.

"Quantitative easing [expanding the money supply] is looming," said economist Michael Gregory of BMO Capital Markets. "I see printing money, high-powered money, as providing excess reserves in the banking system, so the banks will do something with that extra money."