

Central banks signal low rates here to stay

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OTTAWA -- Despite growing confidence that economic growth is in the offing, monetary policy around the world is likely to remain "ultra-accommodative," perhaps until 2011, as doubt remains as to whether or not the growth expected this quarter is sustainable, analysts say.

That is the view emerging following the weekend gathering of the world's leading central bankers in Jackson Hole, Wyo., highlighted by remarks from Ben Bernanke, U.S. Federal Reserve chairman, who warned of the uncertainties ahead, and Jean-Claude Trichet, president of the European Central Bank, who suggested he is in no rush to reverse emergency stimulus measures.

"The key message from Jackson Hole was ... that monetary policy is likely to remain ultra-accommodative for the foreseeable future - at least for the next several years," said Julian Jessop, chief international economist at Capital Economics of London.

"It seems more likely that there will be no increases in interest rates in any of the major economies over the next 12 to 18 months."

Strategists at RBC Capital Markets concurred, adding in a note released Monday: "We continue to believe the economic backdrop will warrant a significant additional period of low rates. Indeed, even at the Jackson Hole conference, there was not even a suggestion that we should be braced for anything other than that outcome."

This outlook applies to Canada as well. Banc of America Securities-Merrill Lynch, as part of global report on monetary policy, said it does not expect the Bank of

Canada to begin raising rates until 2011 - well past its pledge to keep the key policy rate, at 0.25%, until June 2010.

Canada has a significant output gap - the difference between potential and real gross domestic product - and the rate at which money is deployed in the economy, or money velocity, has shrunk 15% since late last year even though the central bank has taken its target rate to its lowest possible level, the BofA-Merrill Lynch analysis indicates.

"To compensate, we think the Bank of Canada will probably need to keep rates lower ... to ensure that money creation remains in the double-digit [growth] territory needed to reflate the economy and close the output gap," the report says.

This outlook is similar to what economists at Laurentian Bank Securities suggested last week. They said a lack of pricing power for firms, a sizeable amount of excess supply and virtually non-existent upward pressure from labour costs means the bulk of policy tightening would not materialize until 2011.

The Bank of Canada signalled in its last economic outlook that it expected economic growth to resume this quarter, marking, technically, the end of a deep but relatively short recession.

It expects growth this quarter of 1.3%, 3% in the final three months of 2009, and the latter again in 2010. Further boosting the recovery story was data from Japan, Germany and France that indicated economic growth in the second quarter.

But there are growing concerns about the sustainability of this emerging recovery.

In a note published last week, Olivier Blanchard, chief economist of the International Monetary Fund, warned of a difficult recovery that would take years to unfold as elements of the financial system remain dysfunctional.

Of particular concern in his outlook was the source of demand once governments phased out fiscal stimuli. The worry is that U.S. business investment and

household spending would remain weak, and Asian economies would fail to pick up the slack.

Still, some leading central bankers warn about leaving interest rates too low too long.

Masaaki Shirakawa, governor at Bank of Japan, told his peers at Jackson Hole that policymakers must avoid economic bubbles fostered by expectations that interest rates will remain low.

"Shirakawa's point about the need to prevent future bubbles is weighing more on minds of central bankers, so maybe they do have to be a little more careful," said David Cohen, director of Asian economic forecasting at Action Economics in Singapore.