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NORTH AMERICAN & INTERNATIONAL ECONOMIC HIGHLIGHTS

Governments and central banks continue to fire from all directions. In the US, the fed funds rate is already at zero. But the Fed continues to ease in different ways. Mr. Bernanke is now targeting not the fed funds rate but rather private sector borrowing rates. By buying spread products, the Fed is trying to lower borrowing cost and stimulate borrowing activity. Bank loans and leases outstanding increased by $8 billion in the latest week, the first rise in four weeks, but are up just 1% from this time last year.

The Bank of Canada's 50 basis points rate cut this week was not the last one for this cycle. Look for the Bank to cut by another 50 basis points come March. This move is already fully discounted by the market and will not have any significant impact on long-term rates.

But even if the Fed and the Bank of Canada are successful in lowering borrowing rates, you still need to create conditions in which households will be willing to borrow. We know that there is some pent up demand for borrowing following the recent decline in US long-term mortgage rates (after the Fed actively purchased MBA securities), refinancing activity has tripled. But in order to insure a sustained rise in credit demand, we need a stronger level of economic activity, and that's where governments enter the picture.

In the US, the Obama Administration will soon introduce an estimated $875 billion in fiscal stimulus and in Canada, we will see roughly $30 billion of new spending this year. A notable portion of this spending will go towards infrastructure. And from an economic perspective, this is important as the economic multiplier of infrastructure spending is significant. After all, when it comes to creating jobs and stimulating activity, infrastructure spending is a much more effective tool than tax cuts. In the US, the impact of economic growth of infrastructure spending worth 1% of GDP is more than double the impact of tax cuts, which have a greater leakage to imported consumer goods, and which risk being saved by households. In Canada, $10 billion of infrastructure spending can potentially create 110,000 jobs and lift economic growth by close to 1.5 percentage points—well above the stimulus effect of a tax cut of a similar size.

And that's the main reason for the renewed optimism by the Bank of Canada, which now calls for a continual recession in the coming six months but a healthy recovery in the second half. This is more or less in line with our ongoing view—the combination of monetary and fiscal stimulus will be powerful enough to turn things around in the second half of the year.

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