

April 30, 2009

Economic Indicators

Canada

	Dec. 2007	Mar. 2009	
GDP ⁽¹⁾	2.7	-2.4 ⁽²⁾	↘
CPI ⁽¹⁾	2.4	1.2	↘
Unemployment	5.9	8.0	↗

United States

	Dec. 2007	Mar. 2009	
GDP ⁽¹⁾	2.0	-2.6	↘
CPI ⁽¹⁾	4.1	-0.4	↘
Unemployment	5.0	8.5	↗

⁽¹⁾ Year-over-year % variation

⁽²⁾ January 2009

Sources: Statistics Canada, U.S. Dept. of Commerce, U.S. Dept. of Labor Statistics.

Equity Indices

% Change	2009 in local currency	2009i n C\$	
S&P/TSX	4.8	4.8	↗
S&P 500	-3.3	-4.4	↘
Russell 2000	-1.6	-2.8	↘
Nikkei	-4.1	-12.0	↘
S&P 350 Europe	-2.1	-8.0	↘

Source: Bloomberg

Monetary Policy For Extraordinary Times

Last week, the Bank of Canada announced its latest interest rate cut, leaving the interbank lending rate to its lowest possible level: 0.25%. This rate cut, which caps a cumulative 4.25% reduction since December 2007, raises a question among investors: Has the Bank of Canada exhausted its capacity to further fight the Canadian recession? The central bank maintains it still has ammunition. In the coming months, it will use two new tools to help re-energize the economy.

The Power of Clarity

The first tool is the adoption of a clear and direct style of communications by the Bank of Canada. A distinguishing characteristic of the latest interest rate change was the clear and direct tone of the announcement. A key element of this statement was the central bank's commitment to maintain the current level of interest rates until June 2010, on the condition that inflation remains in check during this period of time. Central bankers typically don't make this kind of long-term commitment on interest rate policy.

The clarity of the statement contrasts with the usual platitudes of central bank communiqués. It is also consistent with a speech that Governor Carney gave in Yellowstone earlier this month. His "plain talk" can be illustrated by his unusually candid expressions such as "the freefall in domestic demand". To us, the bank's direct language aims to build credibility with the public which is a good thing at a time when financial markets are experiencing a crisis of confidence.

Quantitative Easing

A second tool for recession fighting is an unconventional strategy known to economists as "quantitative easing". This strategy involves the central bank using its power to create new money to purchase securities in the market. In a classic quantitative easing, the bank buys government bonds in the open market. By doing so, it boosts the amount of money in circulation and reduces the quantity of top-quality bonds available, therefore re-directing market demand towards lower quality corporate bonds, improving both the bond issuing corporations' access to capital as well as their borrowing rates. In a more aggressive version of quantitative easing, the central bank purchases corporate bonds directly.

A Perspective for Investors

The Bank of Canada has very clear intentions: it wants to reduce interest rates for a prolonged period of time to jump-start risk taking. We think prudent investors will be wary of taking undue risks and bowing to the pressure from near-zero interest rates. Our second concern is inflation. Increasing the money supply in the economy is often considered a threat to the purchasing power of money. We don't consider a resurgence of inflation as a likely scenario in the short-run because consumer demand is just too weak, but it is more plausible over the coming 2-3 years. With this in mind, investors should think twice before investing into long-dated bonds (10 years +).

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