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Canada and the Economic Crisis: Our Performance and Near-Term Prospects

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Advantages Going into the Crisis

- Well-diversified economy, low unemployment, and low inflation
- Strong corporate and household balance sheets
- Prudent and well-capitalized banking system
- Limited pressures in the housing sector
- Credible and successful monetary policy framework
- Strong fiscal position and extensive social safety net
- Effective national regulatory system

[Charts 1-4](#)

Economic Performance During the Crisis

- Serious real economic effects despite a relatively strong financial sector
- How did Canada do compared with previous recessions?
- How did Canada do compared with other major economies?
- Canada's exposure to global financial markets and to trade (especially autos and commodities)
- Canada's exports and trade-weighted activity in the U.S.

[Charts 5-10](#)

Fiscal and Monetary Policy Responses

- Aggressive monetary policy easing and a conditional commitment to keep rates low
- Unconventional monetary policy options ready if needed
- Significant automatic and discretionary fiscal policy easing
- Extraordinary liquidity support and guarantees for the financial sector
- How do Canada's policy responses compare with those in other countries?

[Charts 11, 12](#)

A Resilient Banking System

- Performance of Canadian banks throughout the crisis
- Nine reasons for their relatively strong performance:
 - (1) Natural conservatism and prudent lending practices
 - (2) A stronger housing sector and mortgage market
 - (3) Less reliance on money market and securitized funding
 - (4) National regulator for banking and insurance
 - (5) Close co-operation among other government agencies and departments

A Resilient Banking System (cont'd)

- (6) Strict limit on leverage and inclusion of most off-balance-sheet activities
 - (7) High Tier 1 capital ratios and heavier reliance on equity financing
 - (8) Effective deposit insurance system
 - (9) Mechanism for the quick, orderly resolution of any problem institutions
- However, there is still room for improvement with regard to both micro- and macrofinancial stability

[Charts 13-17](#)

Near-Term Prospects

- Projected output growth and inflation to 2011
- Factors supporting the recovery:
 - (1) Stronger external demand (especially autos and housing)
 - (2) Rising world commodity prices
 - (3) Improving financial market conditions
 - (4) Increased business and household confidence
 - (5) Stronger equity prices and signs of stability/recovery in housing
 - (6) Continued fiscal and monetary policy stimulus

[Charts 18-25](#)

Near-Term Prospects (cont'd)

- Why the global recovery is expected to be protracted:
 - (1) Synchronous and severe nature of the global financial crisis
 - (2) High household indebtedness and reduced net worth
 - (3) Deleveraging in the financial sector and constrained lending
 - (4) Continuing global imbalances and reduced demand
 - (5) Trade impediments and possible coordination problems

Remaining Risks and Challenges

- Why a smooth recovery is not assured:
 - (1) Uncertain sources of private demand in the global economy
 - (2) Concerns about projected public debt levels in many countries
 - (3) Risks of a disorderly global adjustment
 - (4) Remaining risks in parts of the world financial system
 - (5) Headwinds from a strong Canadian dollar

Remaining Risks and Challenges (cont'd)

- Policy challenges related to the “exit” from a global perspective: Don’t stay too long or leave too early
 - (1) Uncertainty about the timing and sustainability of a recovery
 - (2) Uncertainty about the effectiveness of many unconventional tools
 - (3) Uncertainty about the level and growth rate of potential output
 - (4) High potential costs associated with extraordinary policy measures
 - (5) Increased need for international coordination and careful sequencing

Remaining Risks and Challenges (cont'd)

- Canada's advantage in securing a smooth exit:
 - (1) Fewer extraordinary measures to unwind
 - (2) Credible and clear fiscal and monetary policy frameworks
- Other unfinished business—international financial reform and the G-7/G-20 agenda



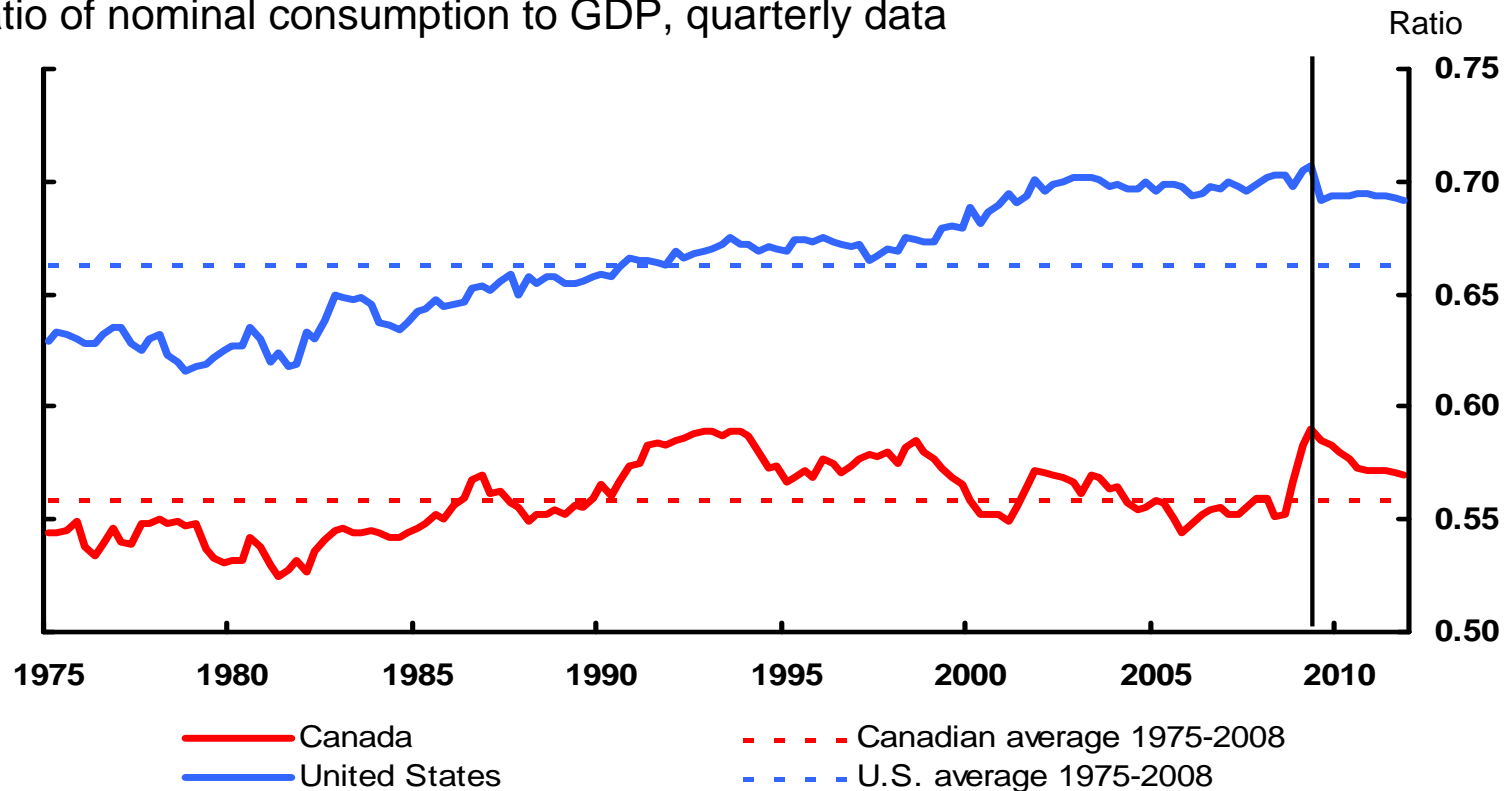
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Chart 1

More balanced household spending in Canada

Ratio of nominal consumption to GDP, quarterly data



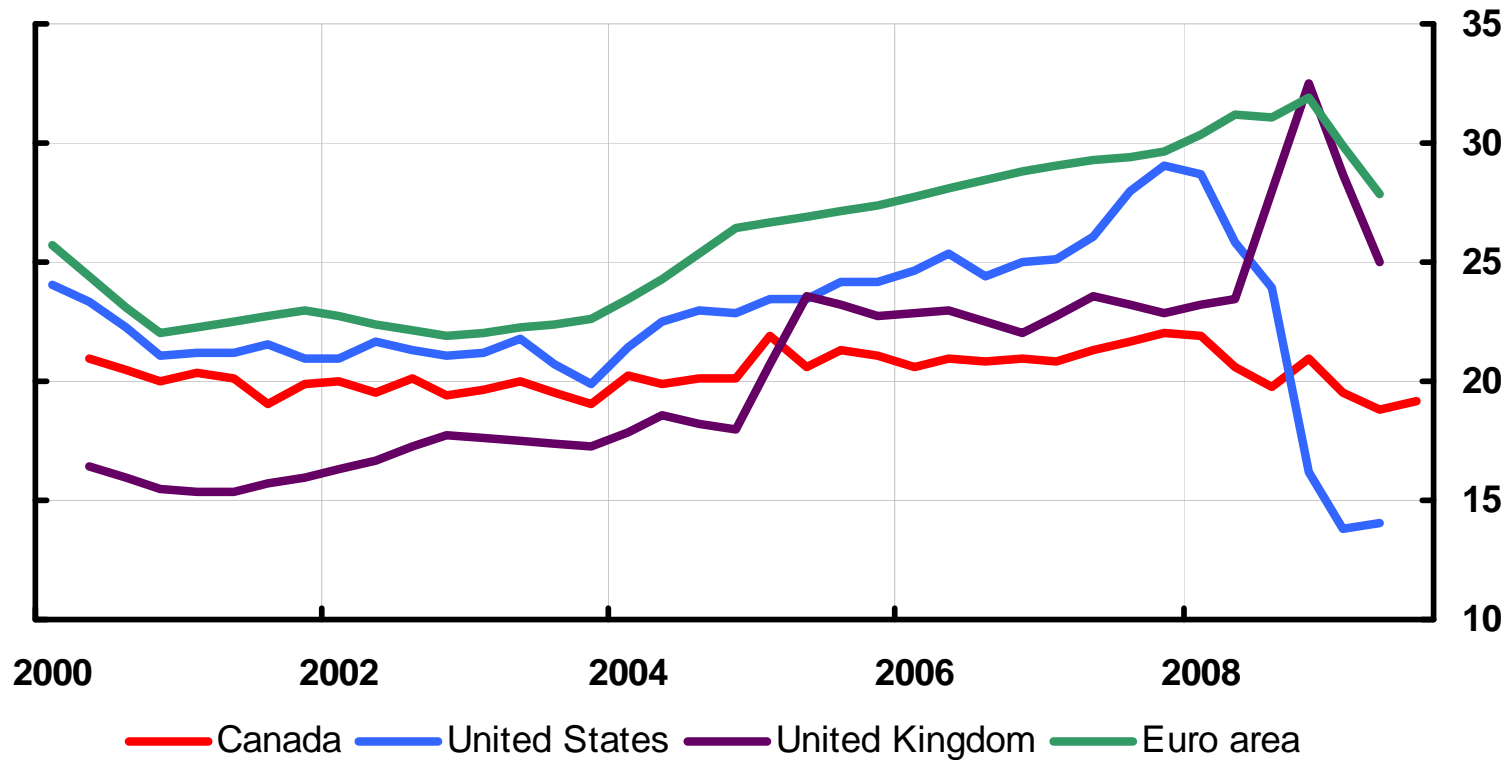
Note: 2009Q3 to 2010Q4 are base-case projections.

Sources: U.S. Bureau of Economic Analysis, Statistics Canada, and Bank of Canada calculations



Chart 2

Lower leverage ratios in Canadian banks



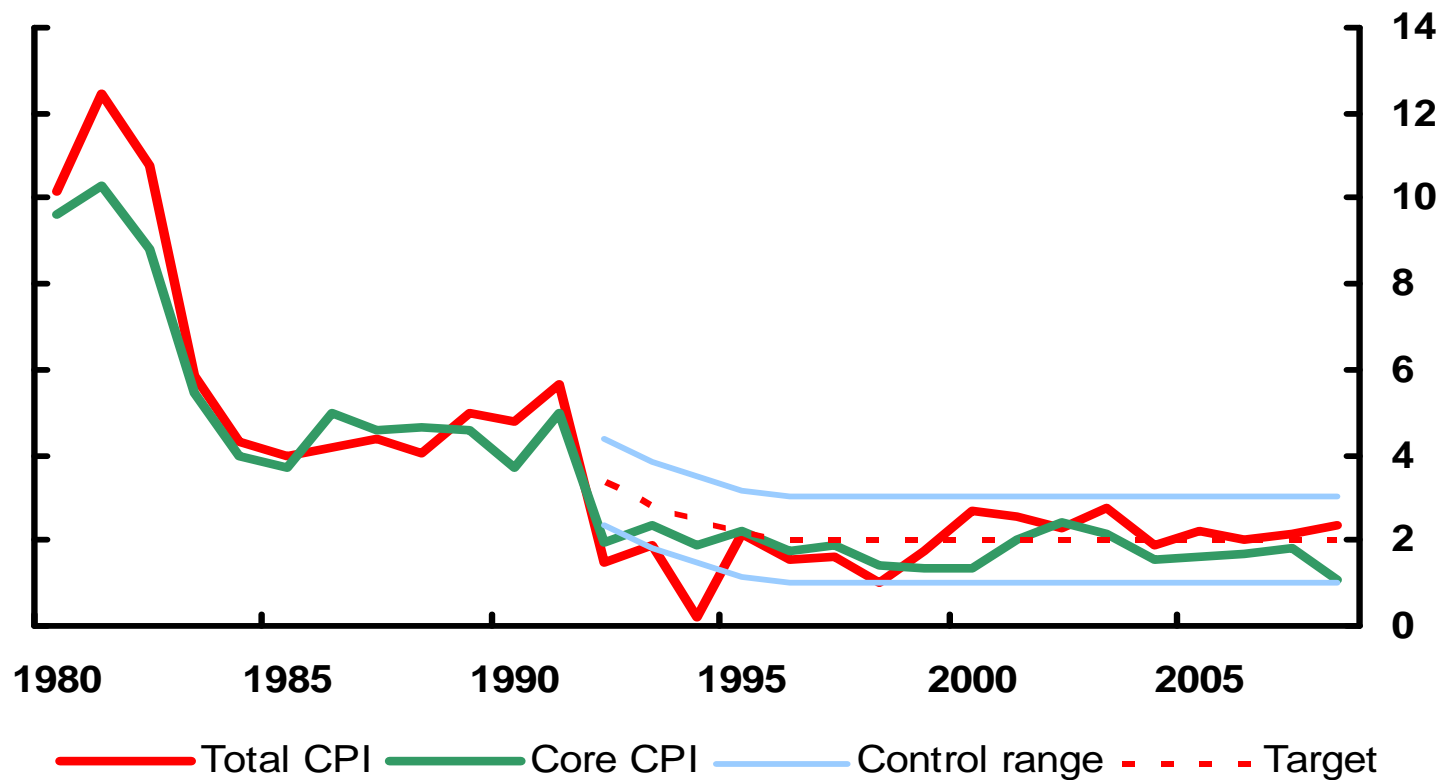
Last Data Point: Fiscal 2009Q2, Canada; Calendar 2009Q1, U.S.; Calendar 2008Q4, U.K. and Europe
Sources: Bloomberg and bank financial statements



Chart 3

Low and stable inflation in Canada

CPI annual averages
Year-over-year percentage change



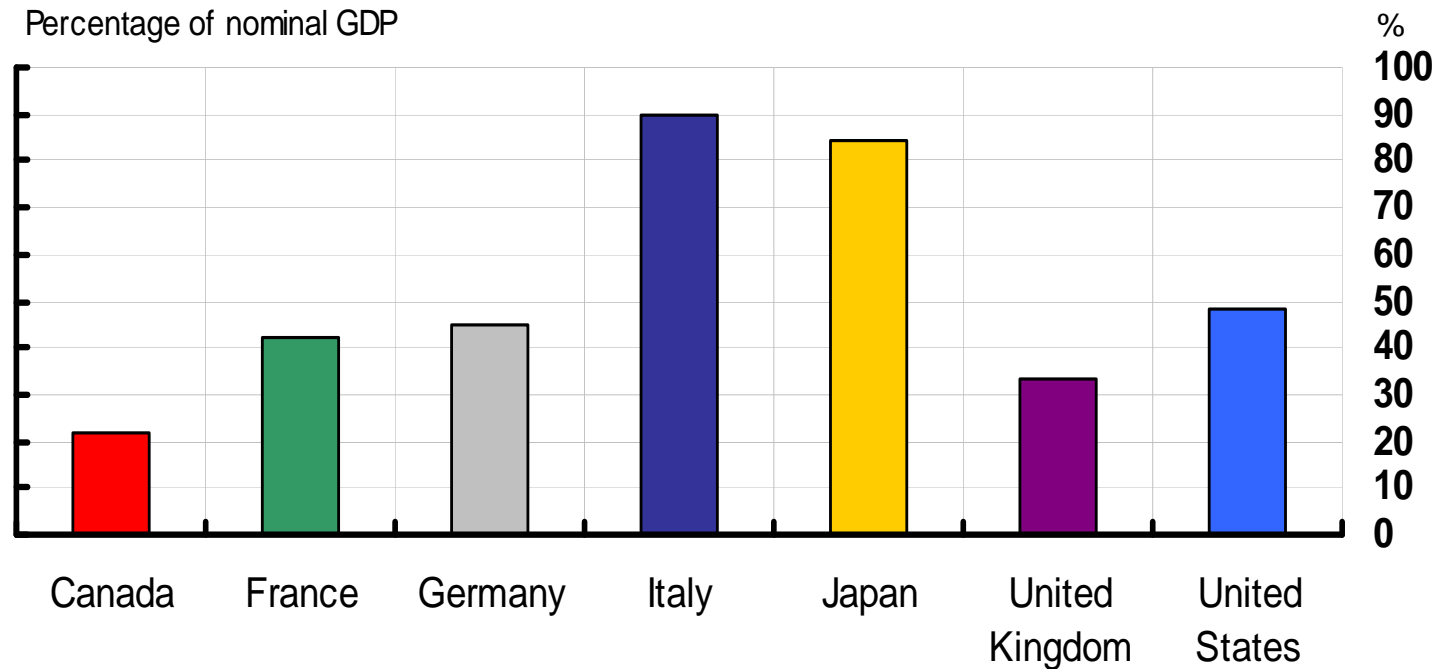
Source: Statistics Canada



Chart 4

Low government debt level in Canada

General government net financial liabilities for 2008
Percentage of nominal GDP



Note: Net debt measures are not always comparable across countries due to different definitions or treatment of debt (and asset) components.

Source: OECD



Chart 5

Cycle-on-cycle comparison with past recessions

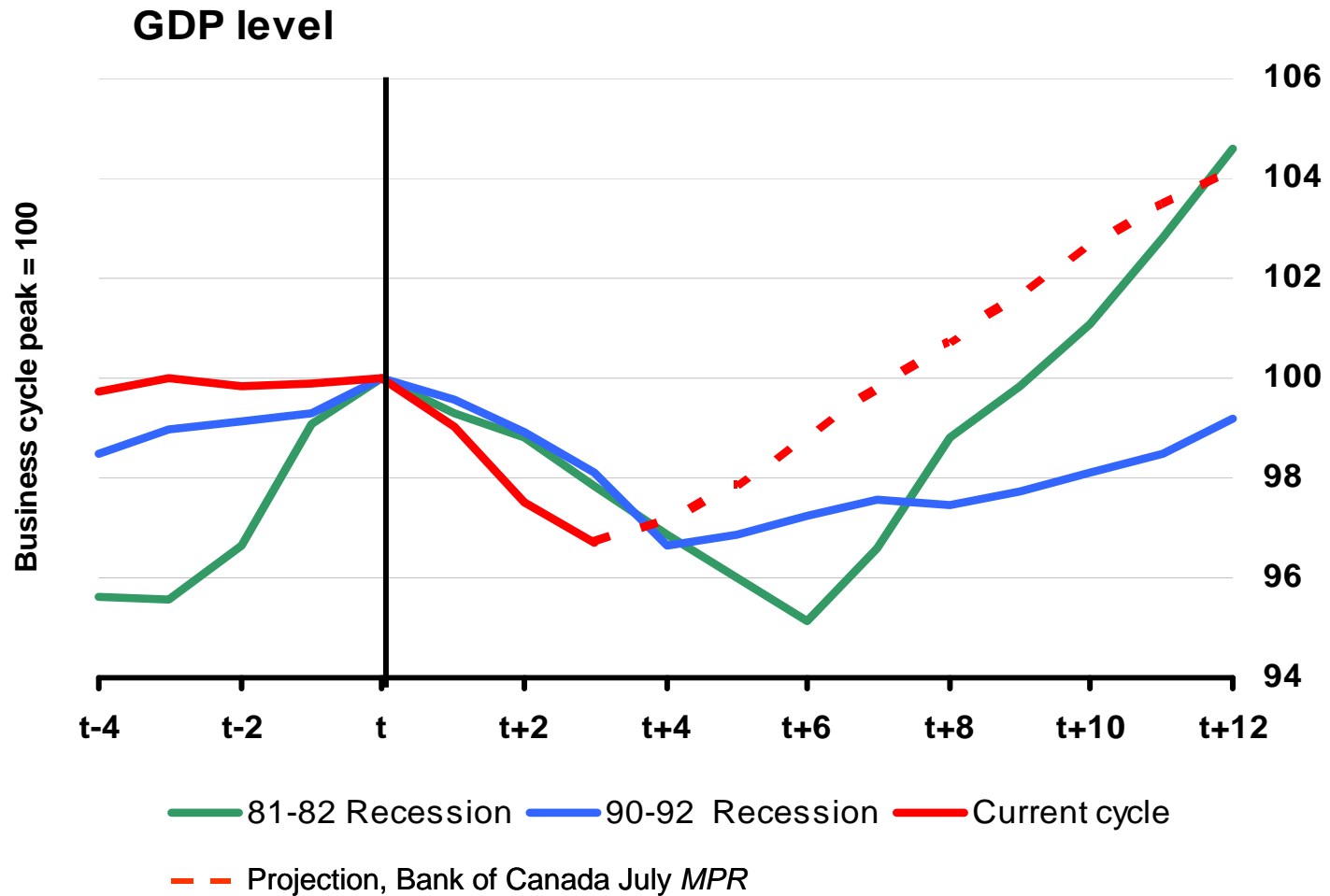
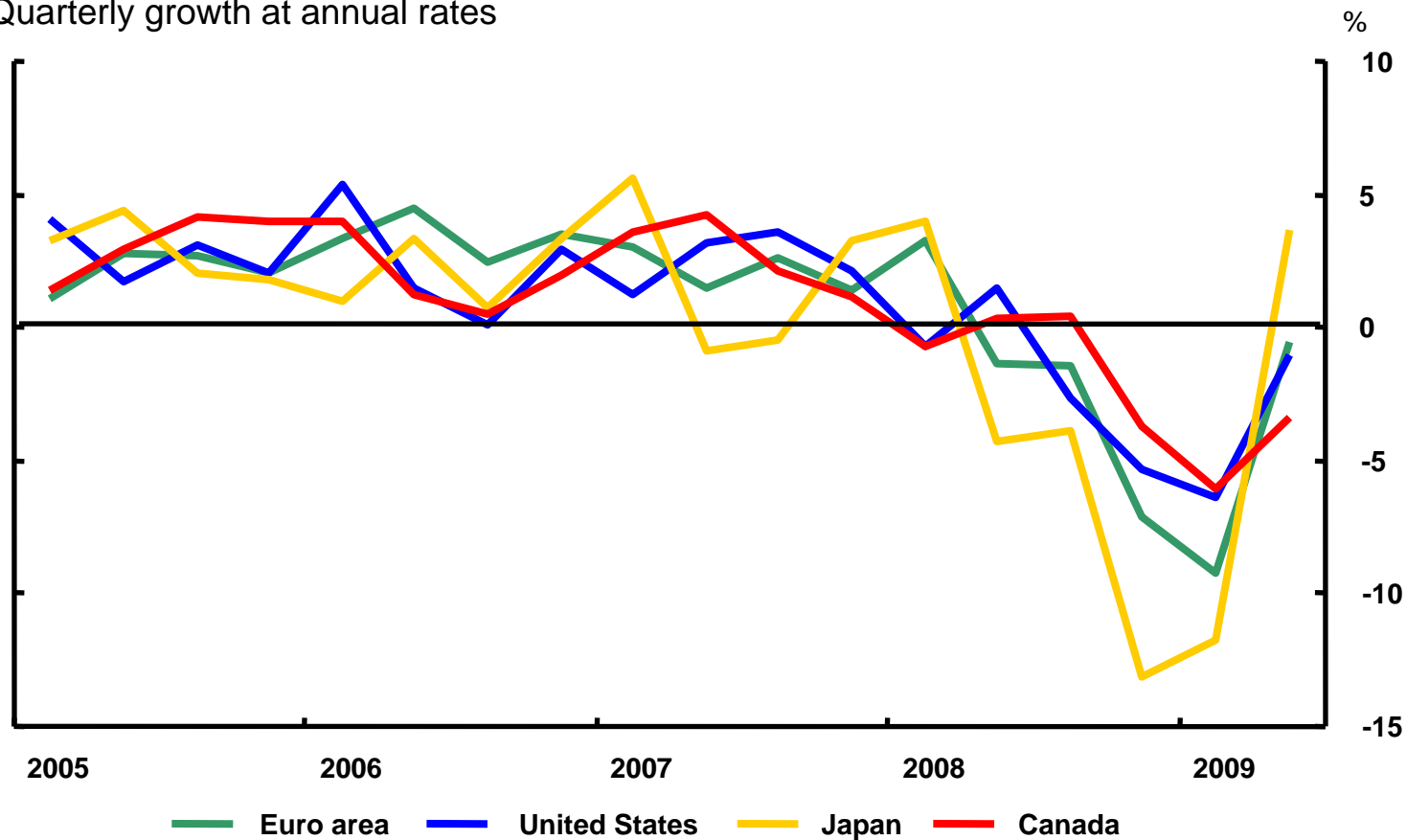




Chart 6

Cross-country comparison of the latest contraction

Real GDP of major economies
Quarterly growth at annual rates



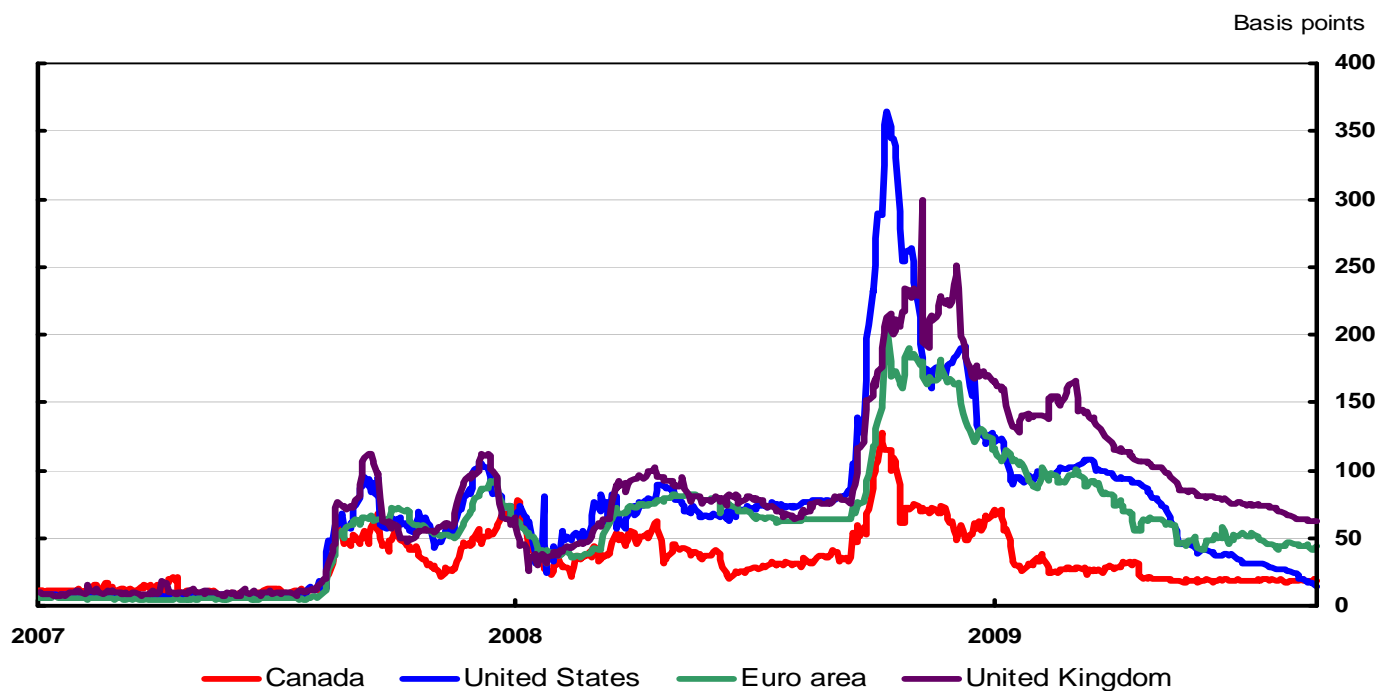
Sources: Statistics Canada, U.S. Bureau of Economic Analysis, Eurostat, Japan Statistics Bureau



Chart 7

Improved short-term funding conditions

Difference between 3-month interbank offered rates and their respective overnight index swaps*



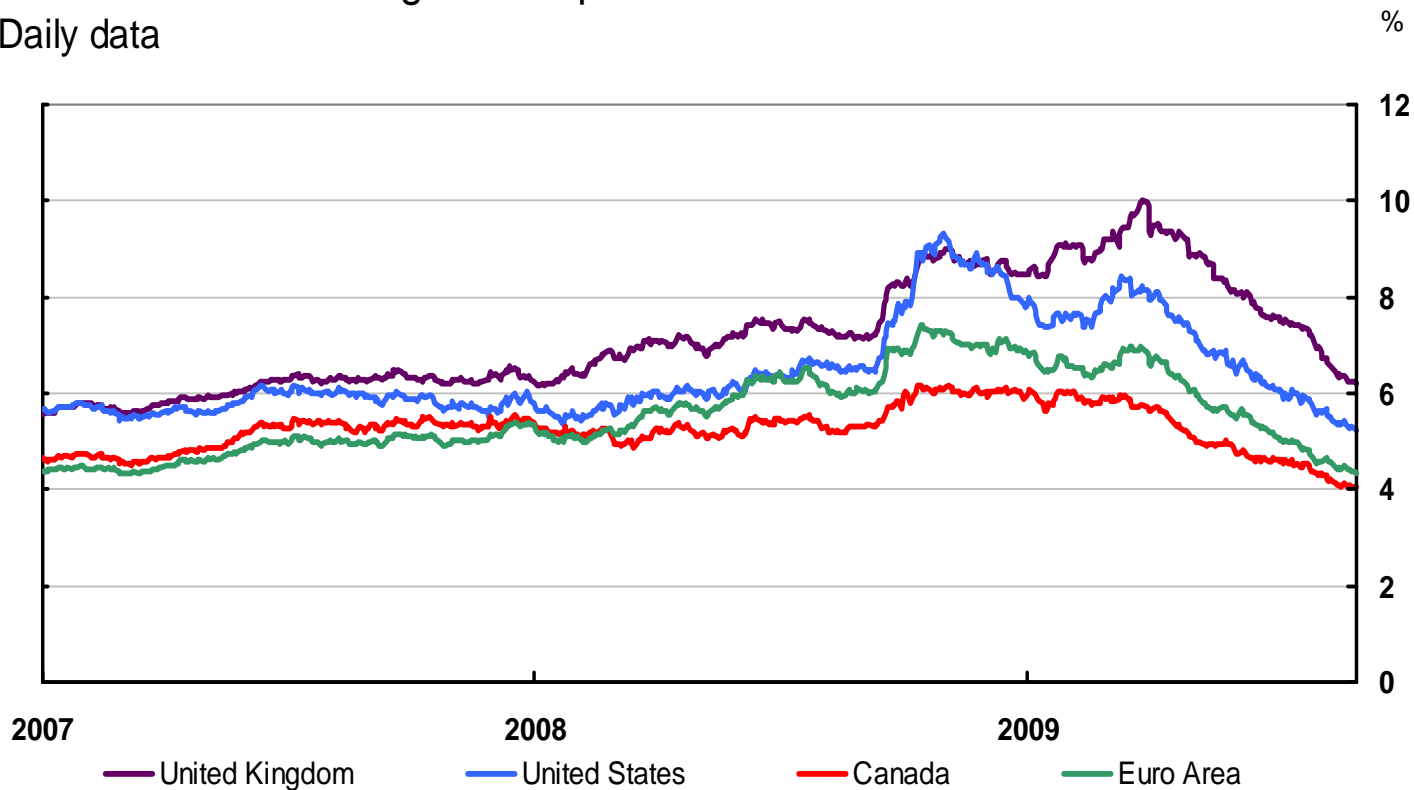
* For the United States and the United Kingdom, LIBOR; for the Euro area, EURIBOR; and for Canada, CDOR
Source: Bloomberg



Chart 8

Borrowing costs for businesses have fallen

Yields on investment-grade corporate bonds
Daily data



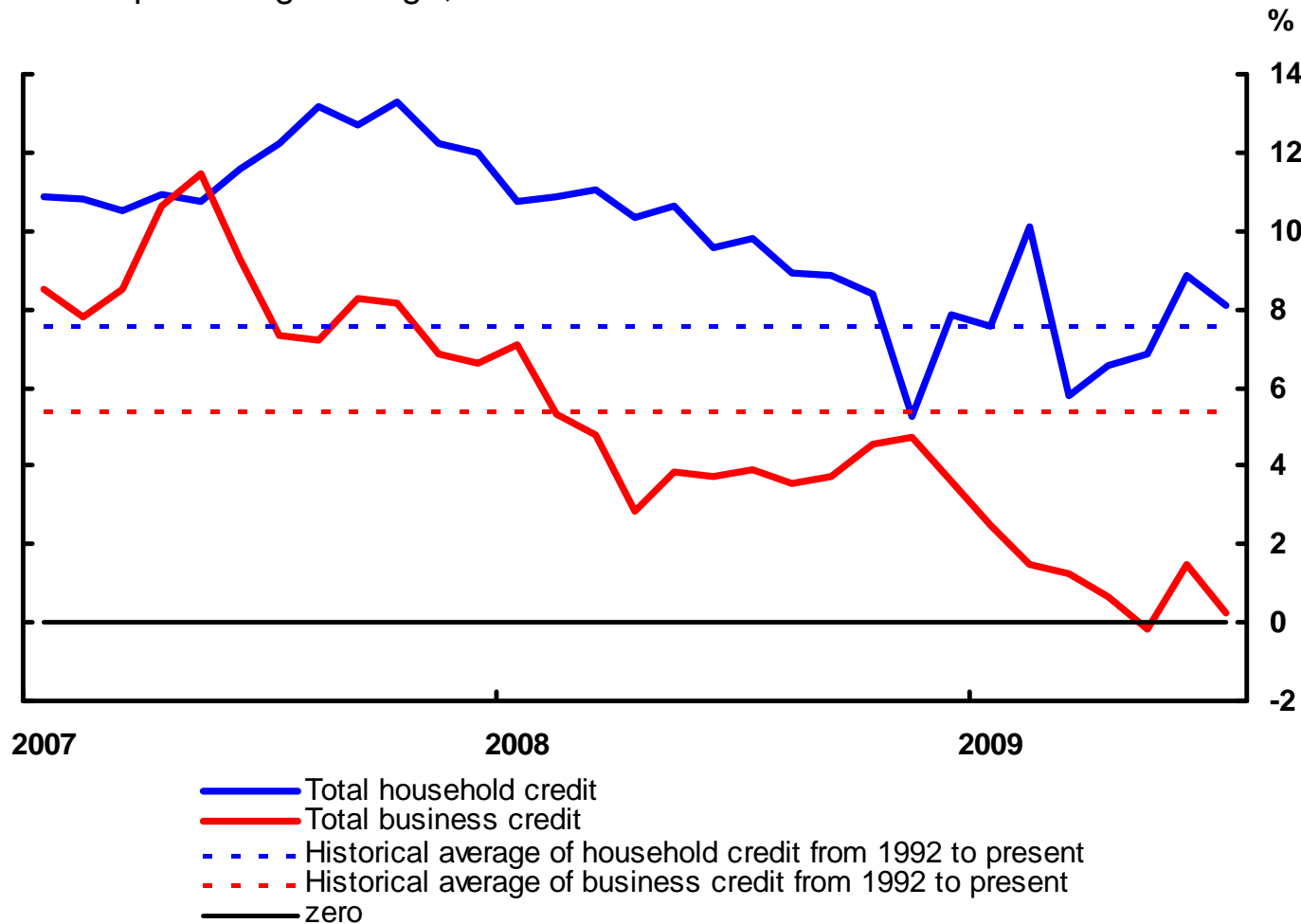
Sources: Merrill Lynch and Bloomberg



Chart 9

Household credit growth in Canada remains robust

3-month percentage change, annualized

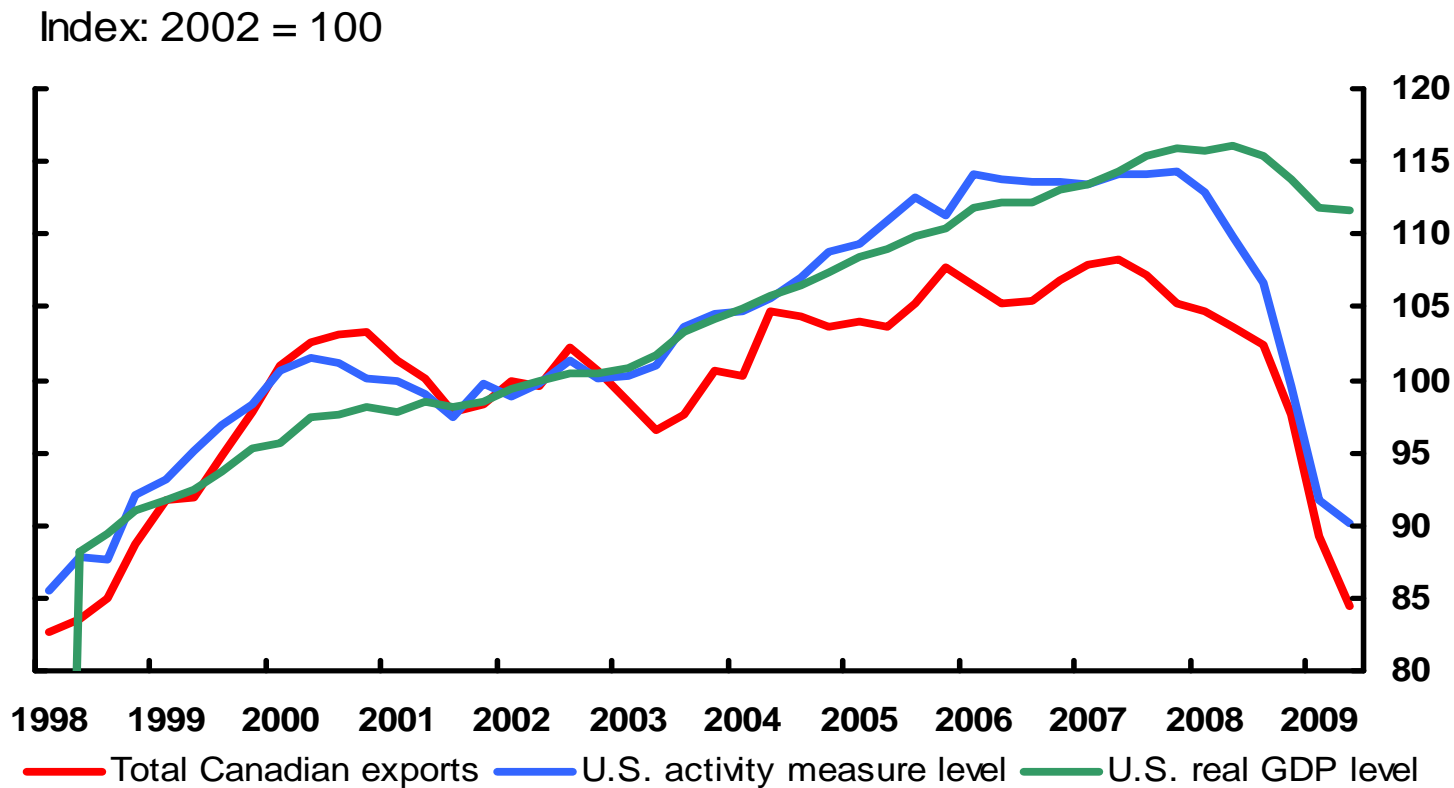


Source: Bank of Canada



Chart 10

Canadian exports and U.S. activity

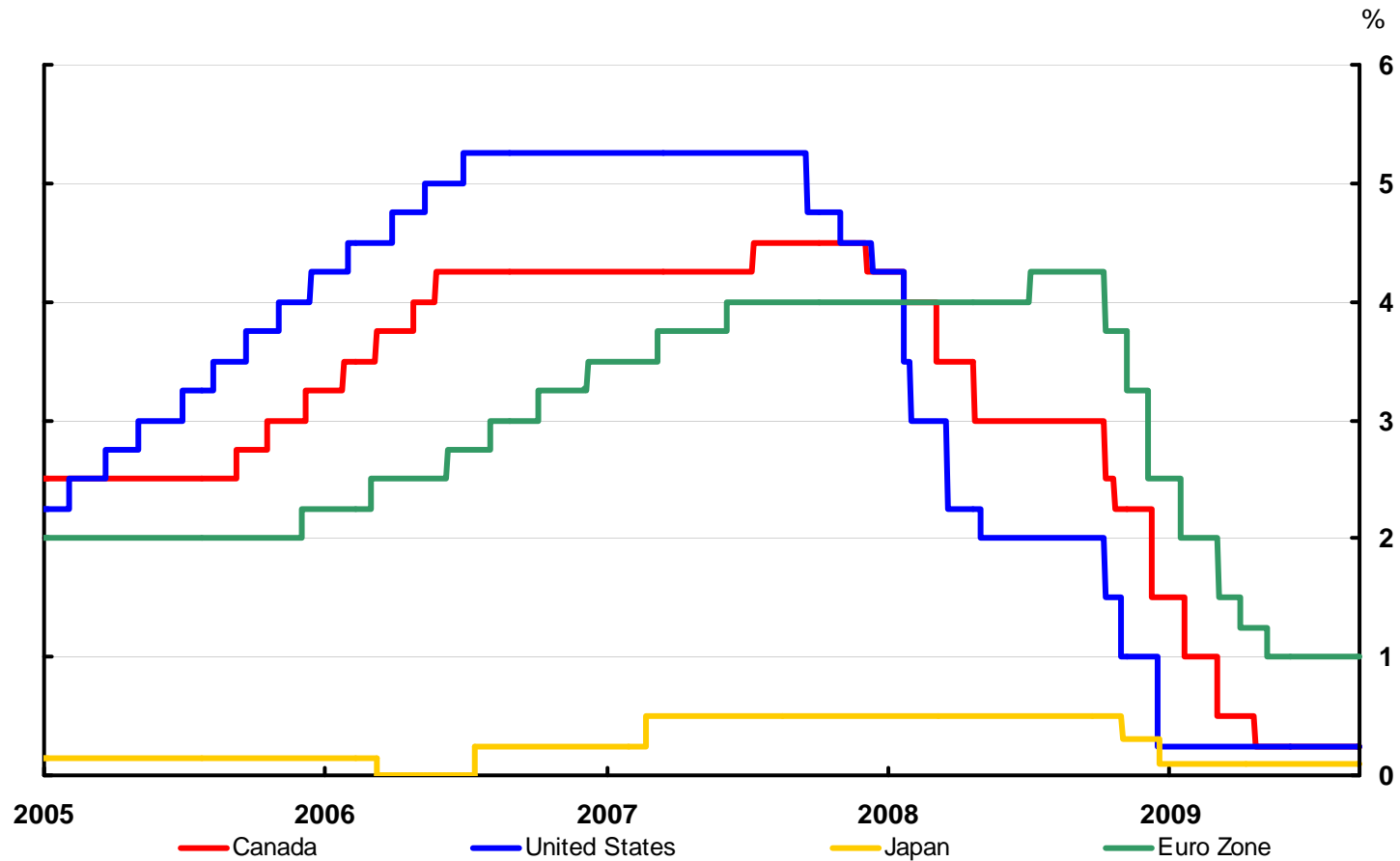


Sources: U.S. Bureau of Economic Analysis, U.S. Federal Reserve, Statistics Canada, and Bank of Canada calculations



Chart 11

Policy rates at the effective lower bound



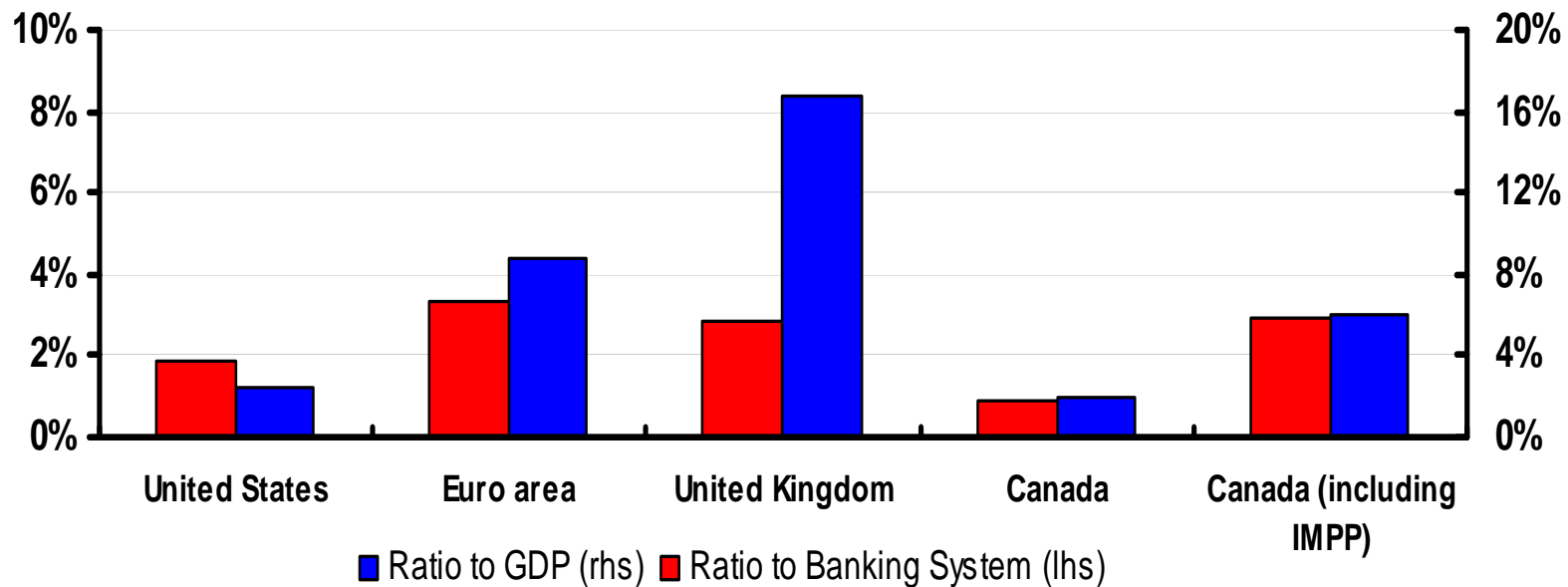
Sources: Bloomberg, Bank of Canada, U.S. Federal Reserve, Bank of Japan, Bank of England, and European Central Bank



Chart 12

Less need for liquidity injections in Canada

Total public sector liquidity extension



Note: Liquidity extension refers to central banks' liquidity-providing operations, as well as foreign currency swaps with other central banks, but excludes outright securities purchases.

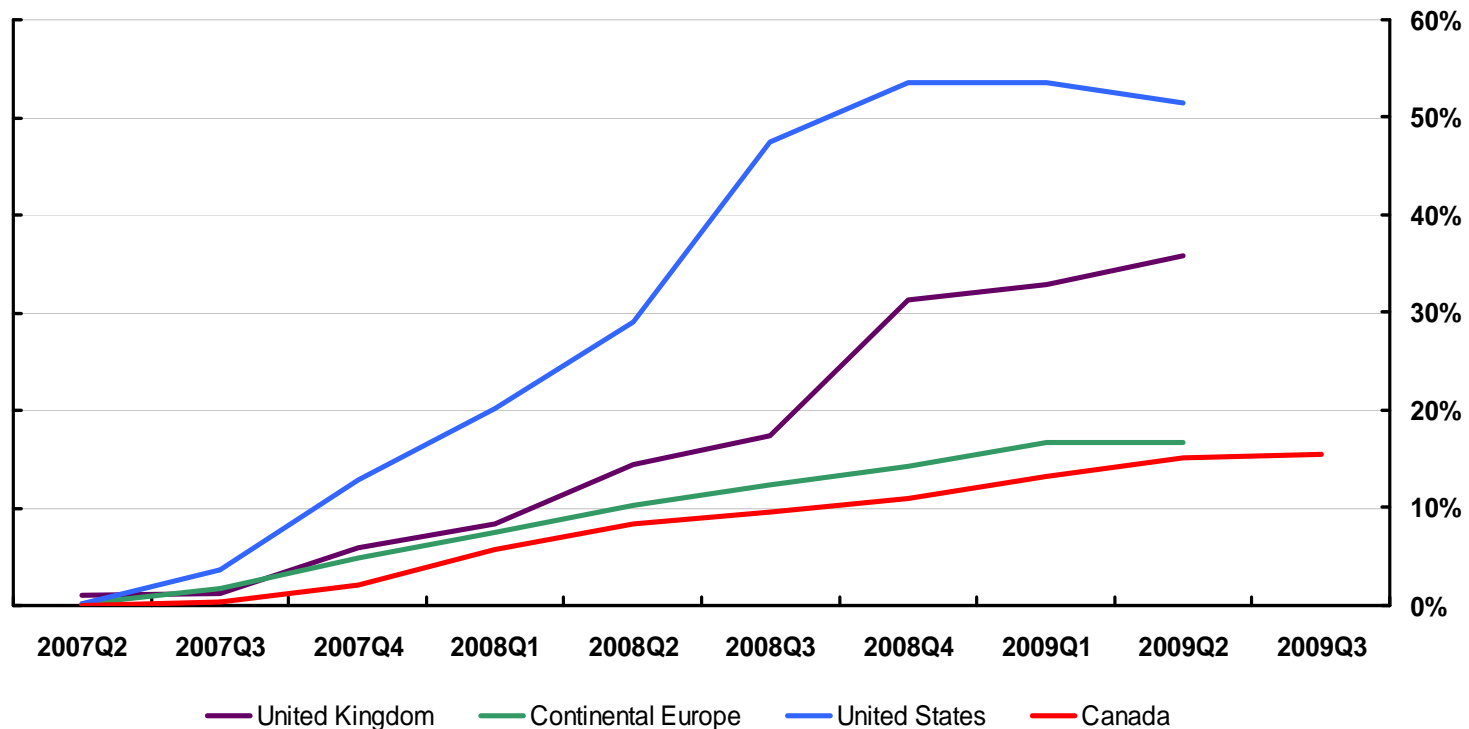
Sources: Bank of Canada, U.S. Federal Reserve, Bank of England, and European Central Bank



Chart 13

Conservative risk appetite of Canadian banks

Cumulative writedowns as a share of shareholders' equity



Sources: Bloomberg and banks' financial statements



Chart 14

More conservative Canadian mortgage market

Mortgage debt as a per cent of nominal GDP

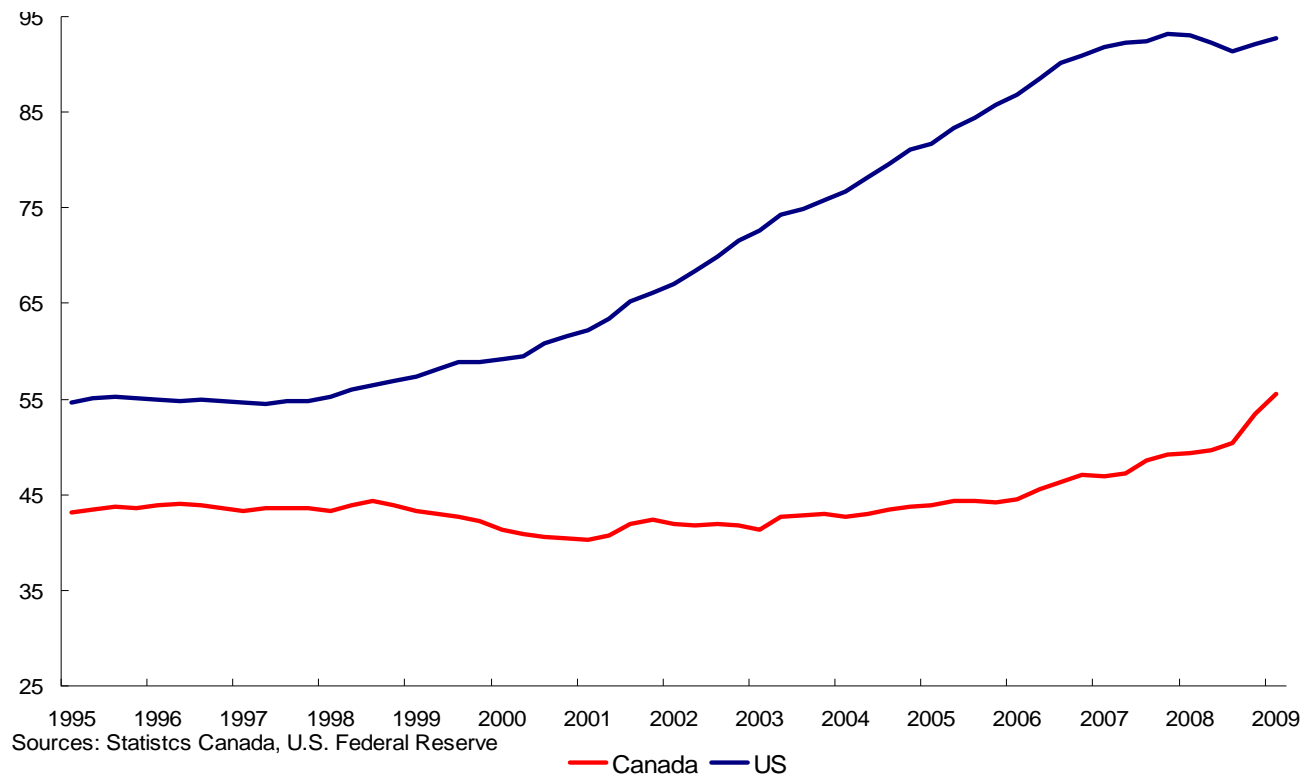
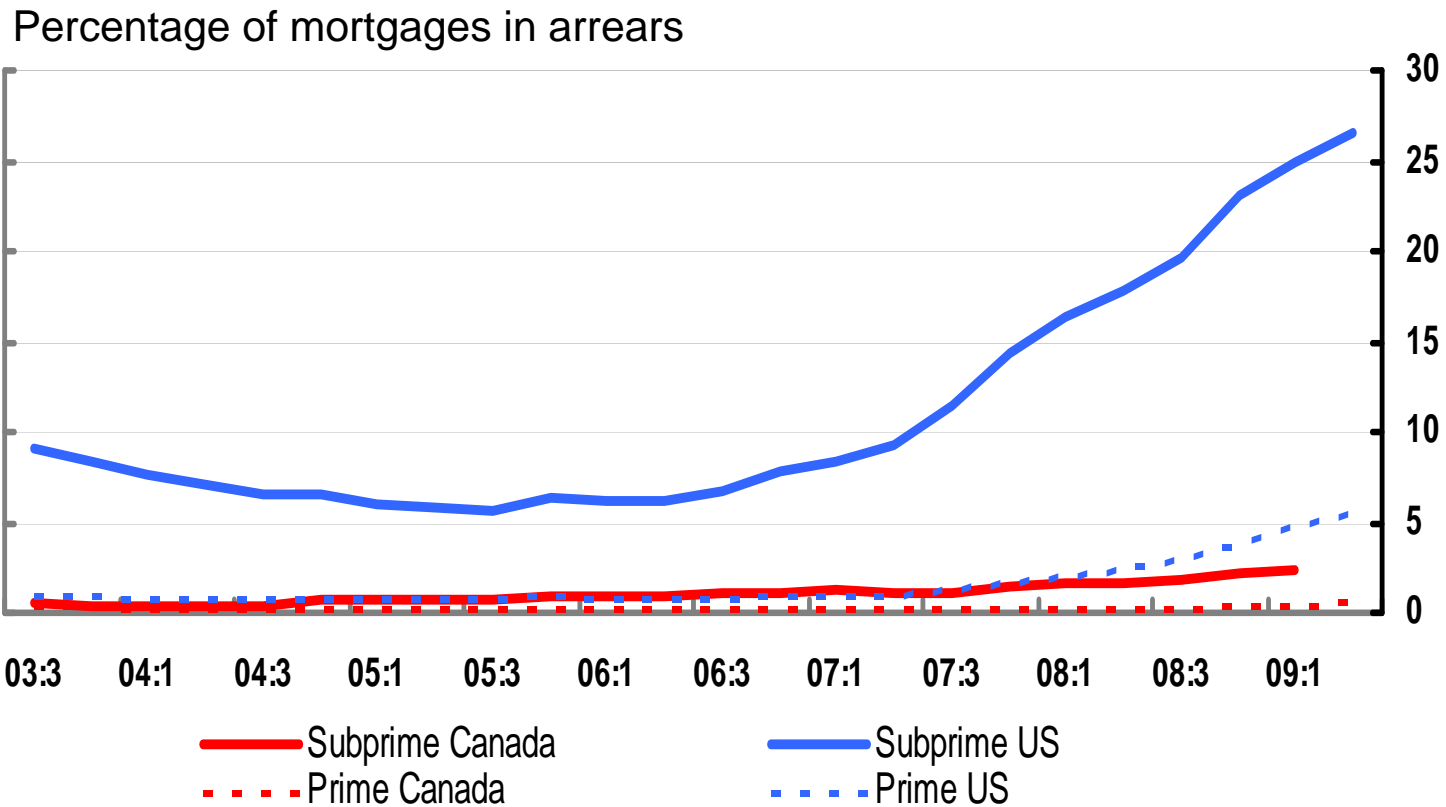




Chart 15

Healthier mortgage market in Canada

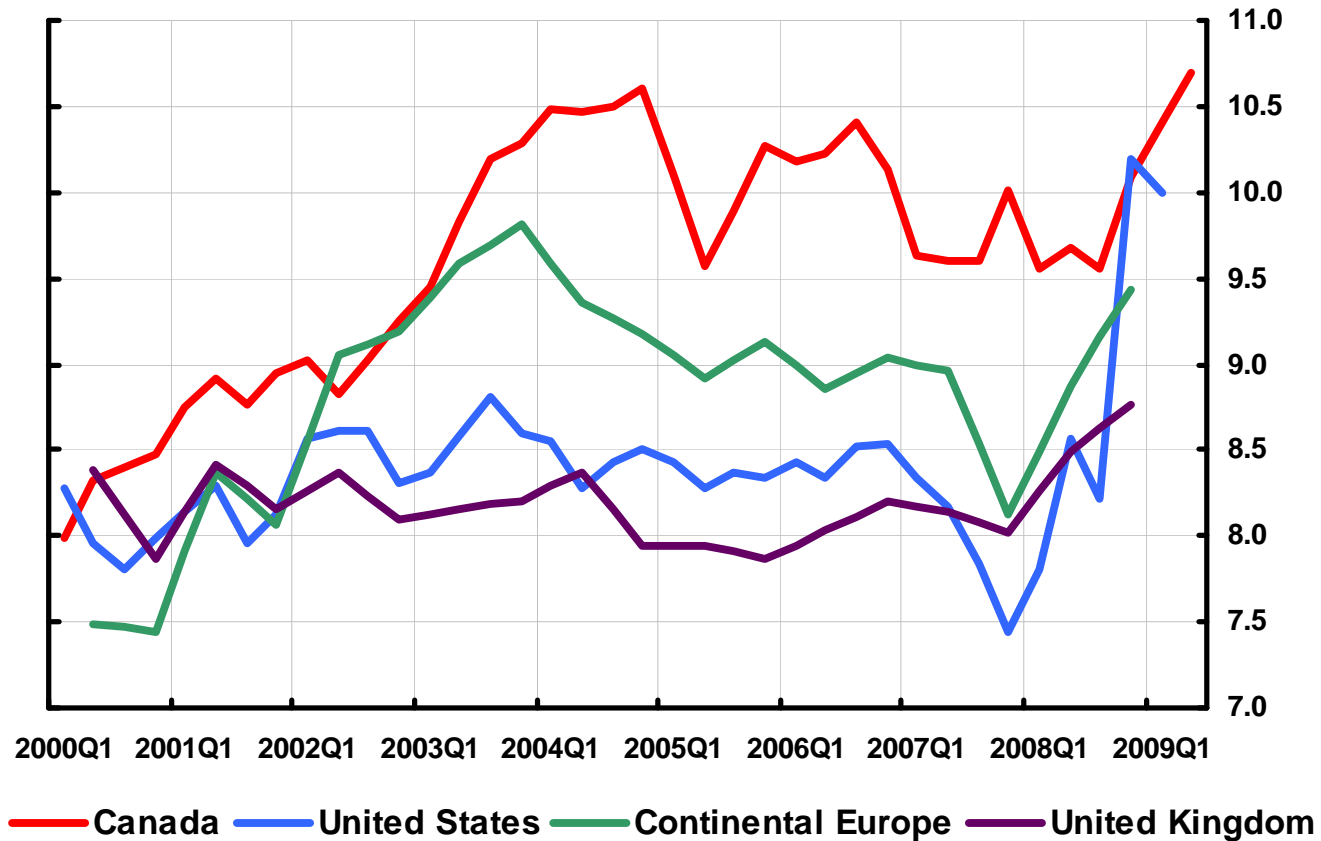


Sources: For Canada, Bank of Canada calculations; for U.S., Mortgage Bankers Association



Chart 16

Higher Tier 1 capital ratios in Canada



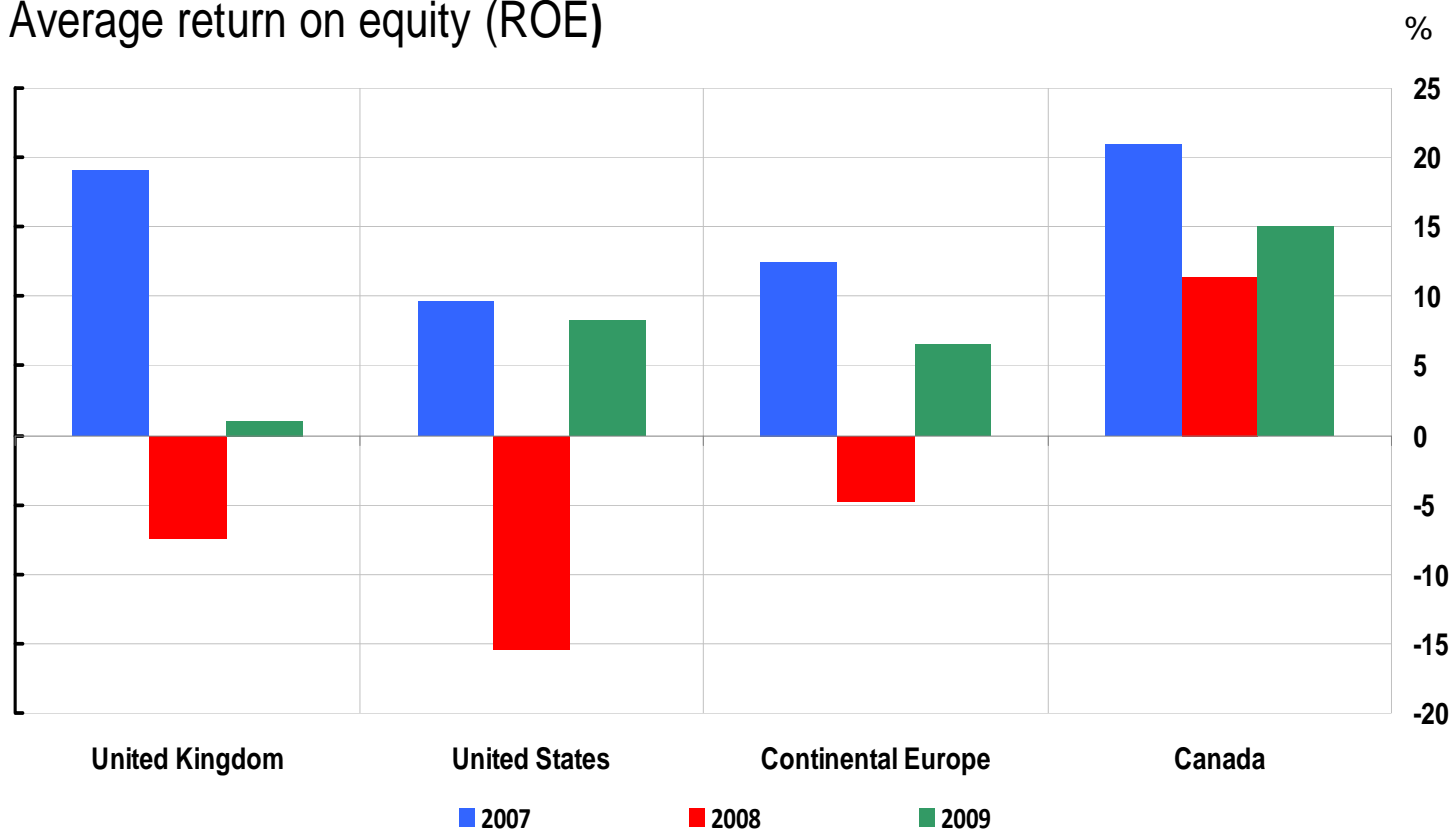
Sources: Bloomberg and banks' financial statements



Charts 17

Rate of return at major banks

Average return on equity (ROE)



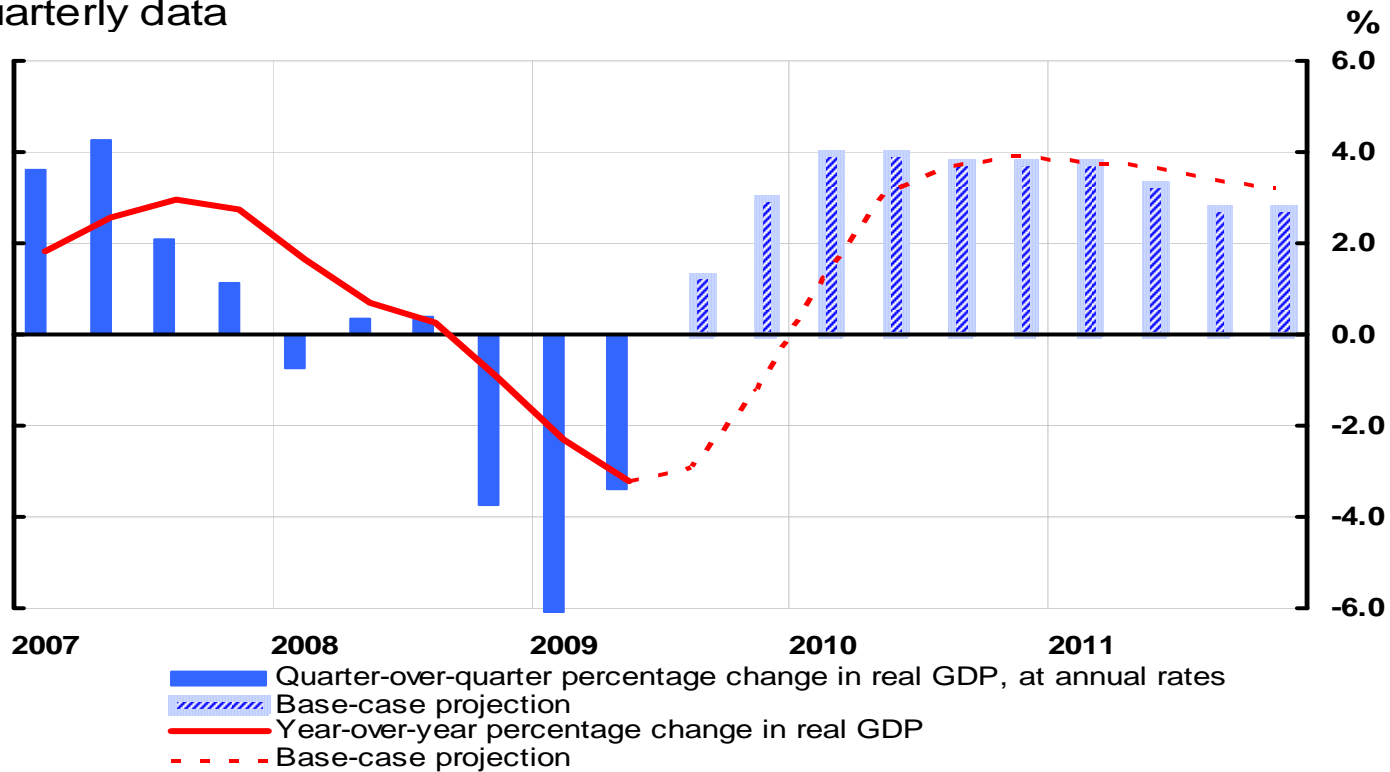
Sources: Bloomberg and banks' financial statements for 2009.
Represents fiscal Q3 for Canada; calendar Q2 for U.S.; and H1 for U.K. and Europe



Chart 18

Recent and projected real GDP for Canada

Real GDP growth
Quarterly data

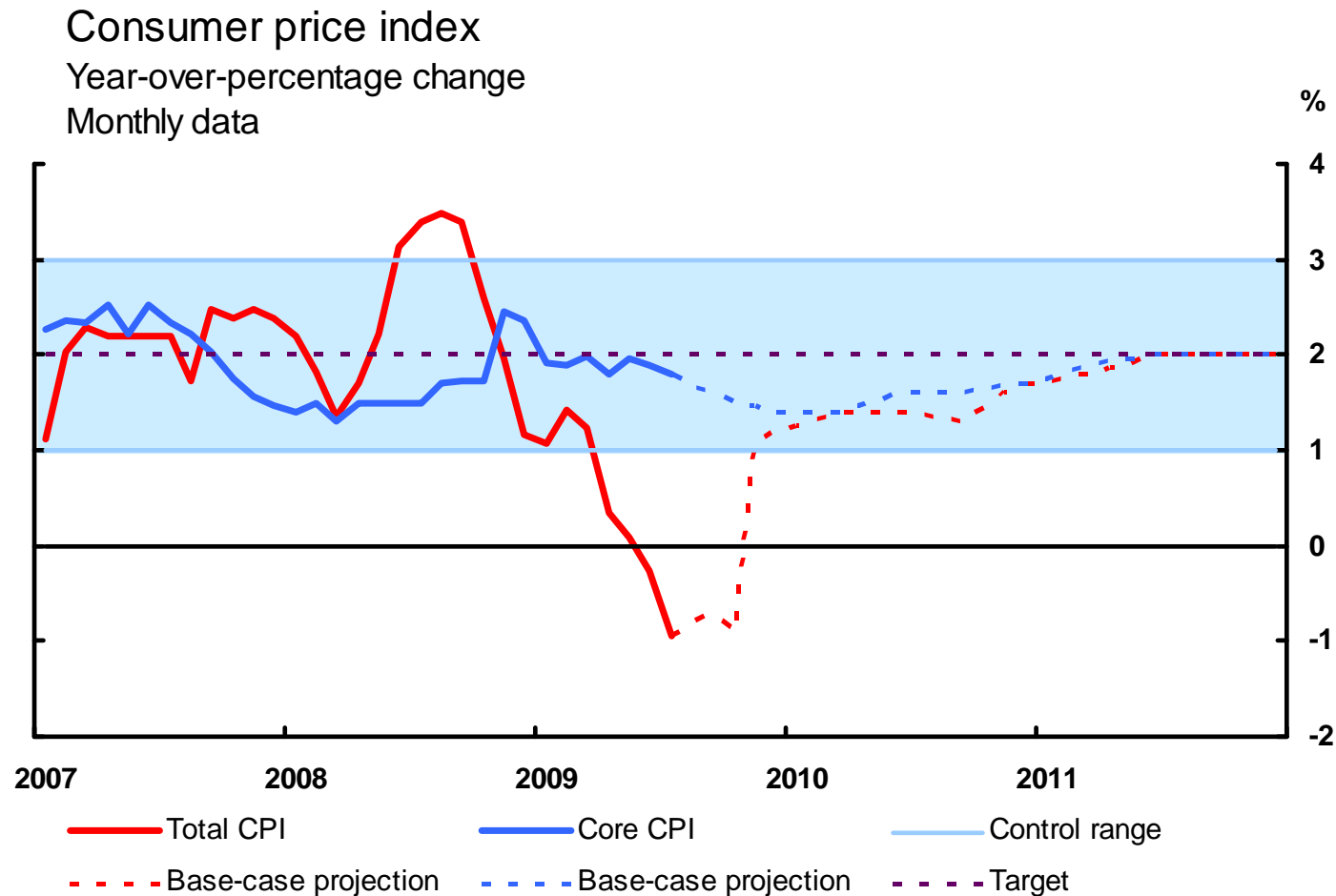


Sources: Statistics Canada and Bank of Canada July *MPR*



Chart 19

Recent and projected CPI inflation rates for Canada



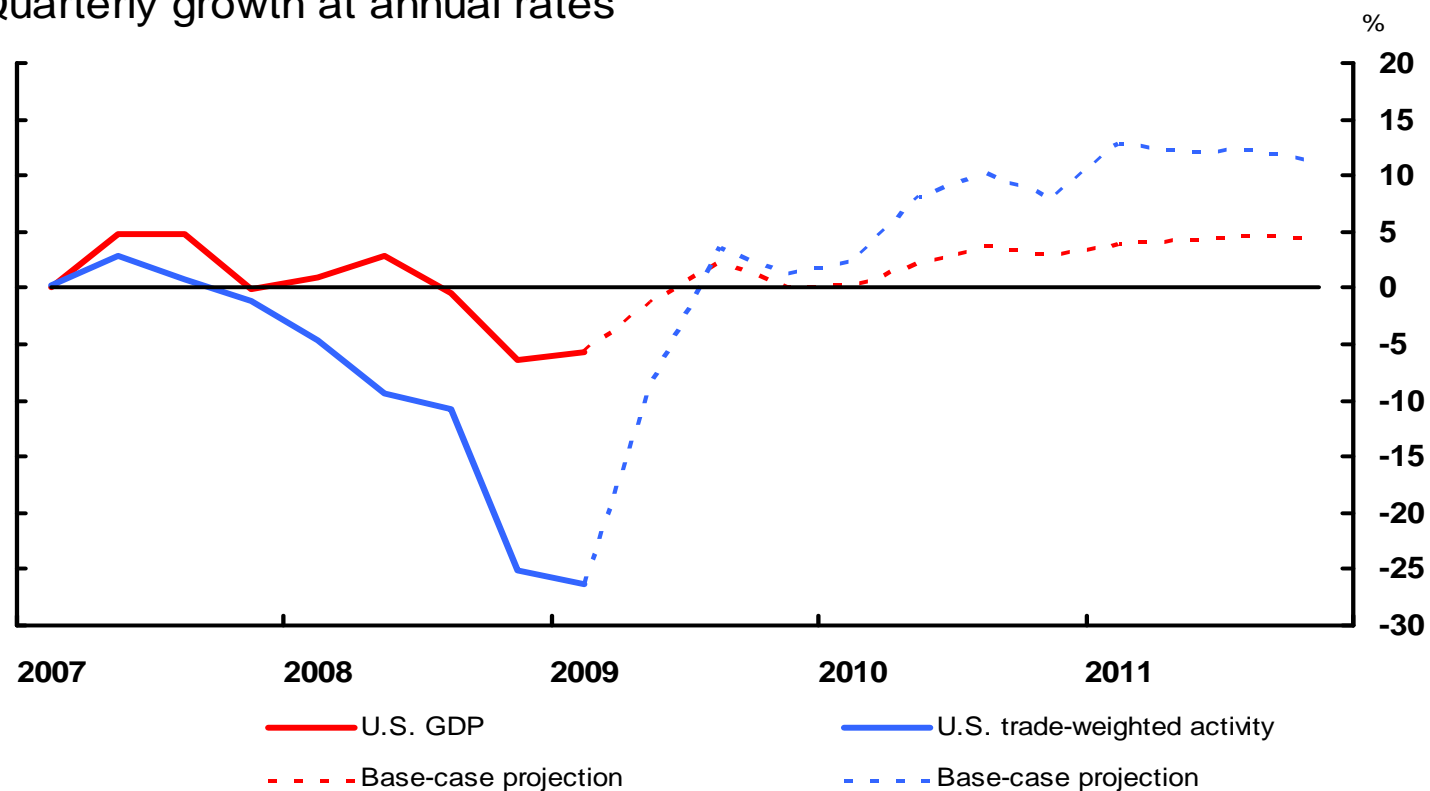
Sources: Statistics Canada and Bank of Canada July *MPR*



Chart 20

Changing composition of U.S. demand

Quarterly growth at annual rates



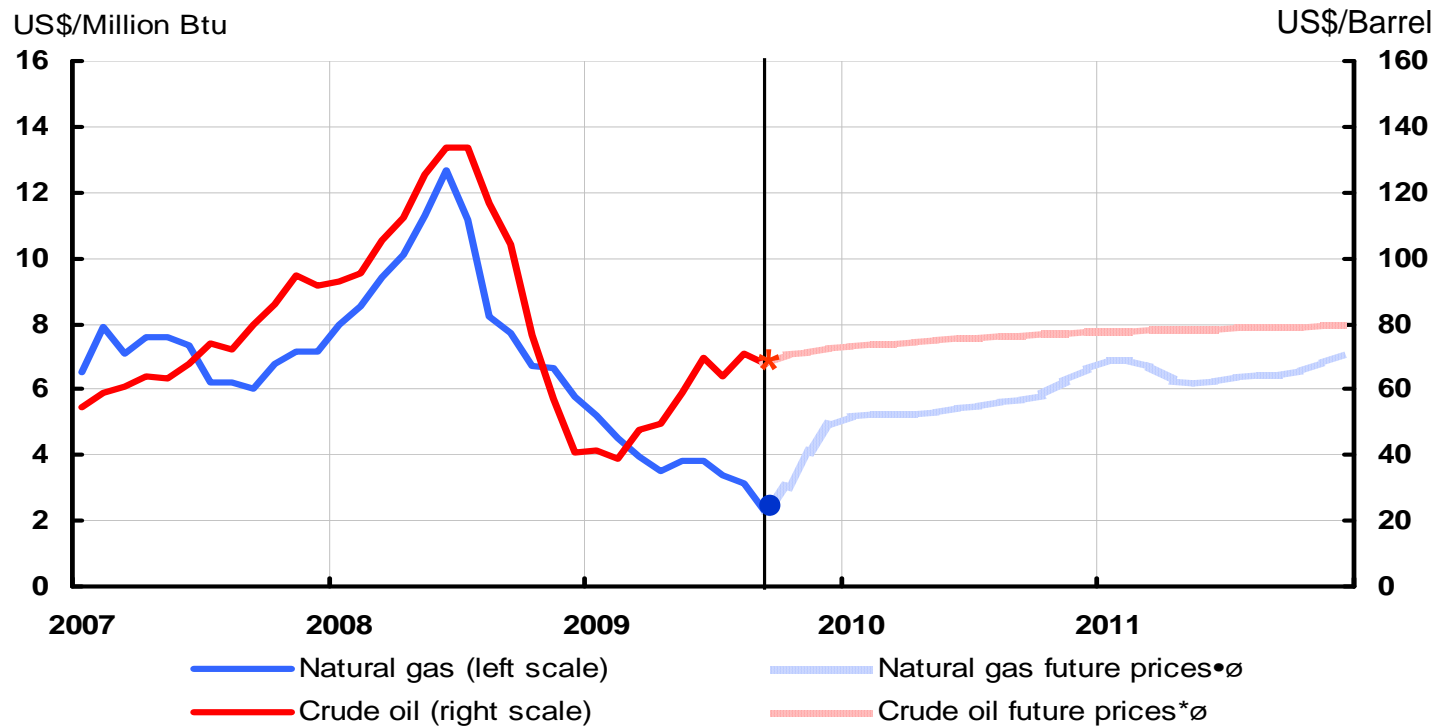
Sources: U.S. Bureau of Economic Analysis and Bank of Canada July *MPR*



Chart 21

World energy prices expected to rise

Crude oil and natural gas prices
Monthly data



* Spot price for crude oil (3 September 2009)

• Spot price for natural gas (3 September 2009)

∅ Based on an average of futures contracts over the two weeks ending 3 September 2009

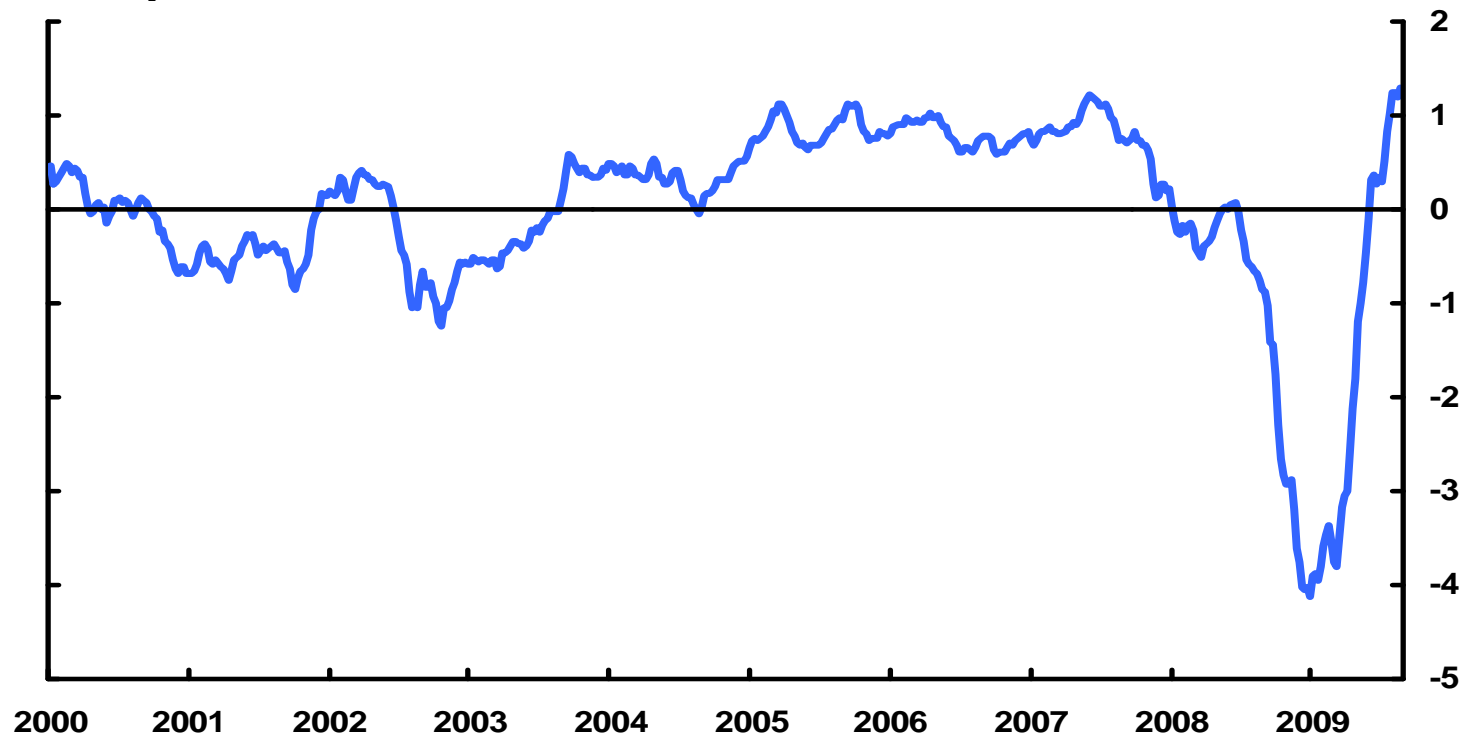
Source: NYMEX



Chart 22

Improved financial conditions in Canada

Financial conditions index (FCI)
Weekly data



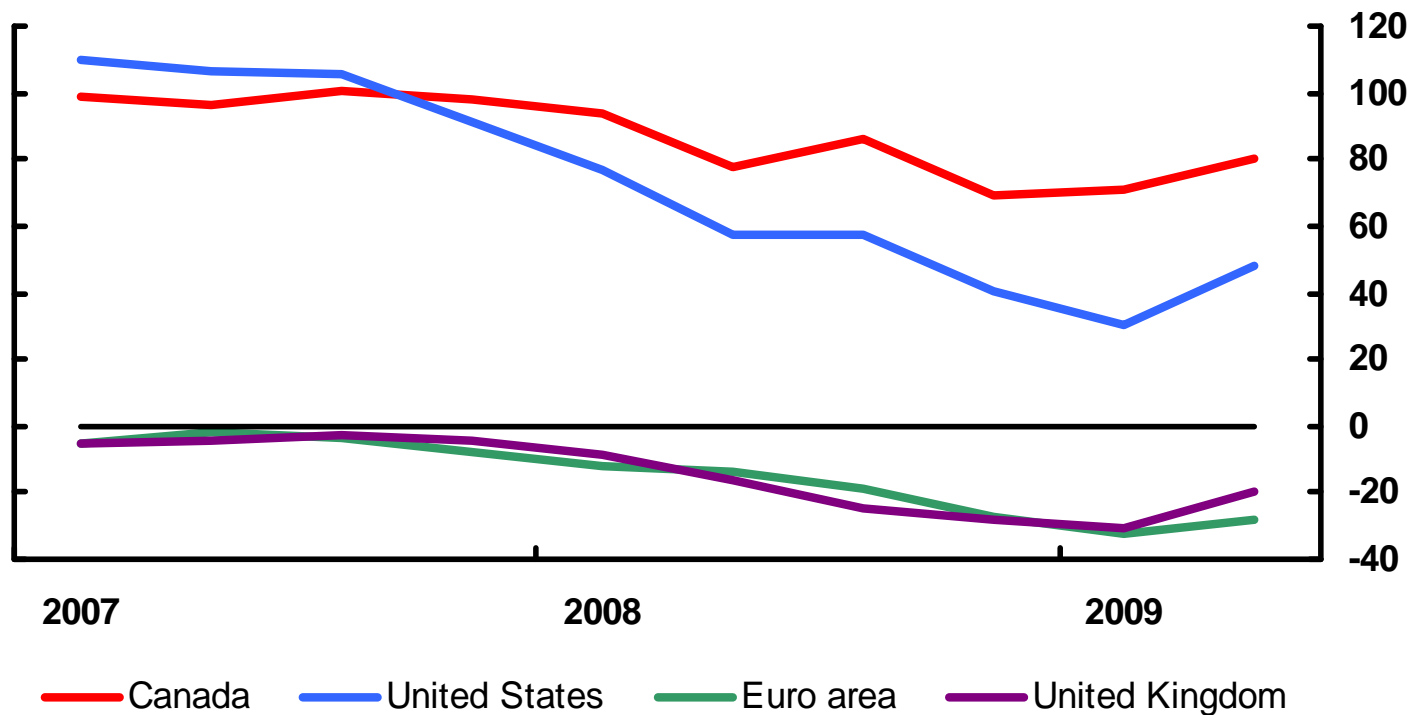
Source: Bank of Canada calculations



Chart 23

Improved household confidence in Canada

Quarterly data

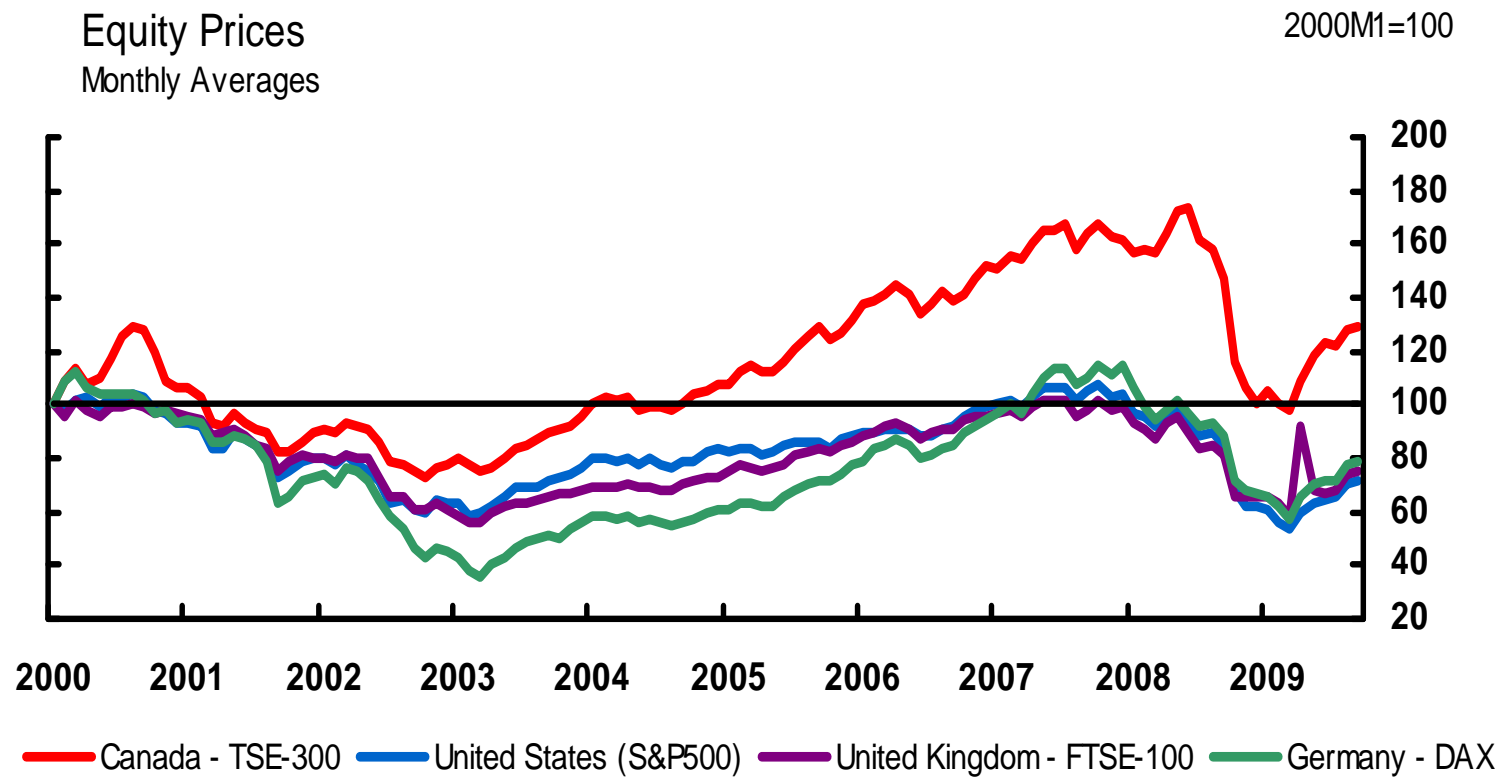


Source: Conference Board of Canada and Global Insight



Chart 24

Stronger equity prices

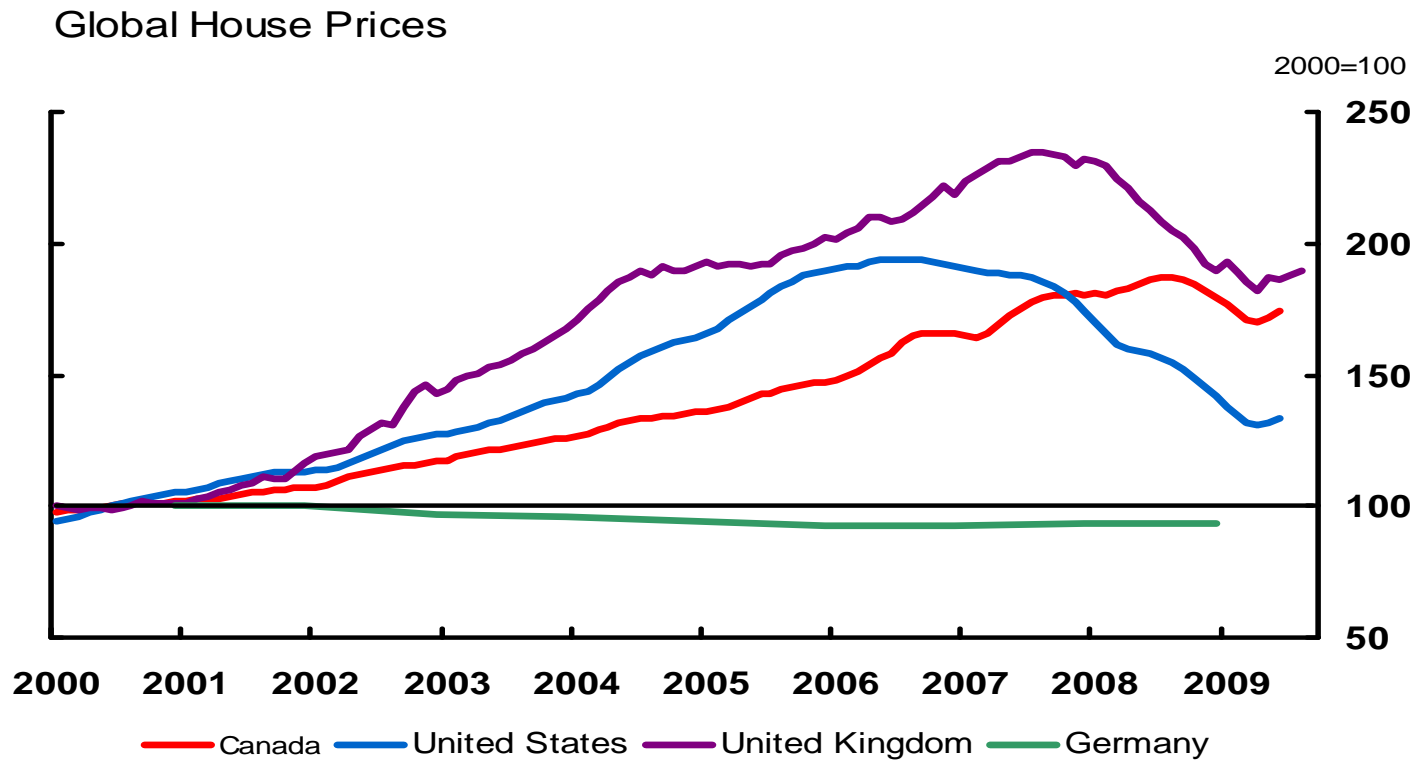


Sources: Reuters for Canada, United Kingdom and Germany; and National Sources for United States



Chart 25

Signs of stability in housing



Sources: Teranet-National Bank House Price Index for Canada; Global Insight for United States and United Kingdom; and National Sources for Germany