BANK OF CANADA
BANQUE DU CANADA

Opening statement by Pierre Duguay CHECK AGAINST DELIVERY
Deputy Governor of the Bank of Canada
to the House of Commons Standing Committee on Finance
5 March 2009

Good morning. Thank you for inviting me here to discuss the Bank of Canada's perspective on the stability of the Canadian financial system.

As we have consistently emphasized, stabilization of the global financial system is a precondition for economic recovery, both globally and in Canada. To that end, policy-makers around the globe have acted aggressively and creatively by initiating a series of unprecedented actions aimed at stabilizing the global financial system. Central banks throughout the world, including the Bank of Canada, have provided unprecedented liquidity to keep the financial system functioning.

Because the crisis we are facing is global in nature and began outside our borders, most solutions must be found at the international level. We are taking part in discussions with our international colleagues on ways to strengthen financial stability globally. I would note that there has been a great deal of interest worldwide in the resilience of Canada's financial institutions in the face of the global economic crisis. Unlike their counterparts in other major economies, Canadian banks have not been materially affected by the financial crisis. They have managed to raise capital during this troubled period to support continued lending and to make up for some of the decline in the demand for securitized products as well as the exit of non-bank lenders which had relied on securitization for financing their activities. In contrast, banks in most other major economies have suffered significant losses and have required significant capital injections from their governments. Thus, Canada has maintained much healthier credit conditions since the onset of this global recession than have been seen in other major countries. Still, the Canadian financial sector has felt the effects of the global turmoil which has increased funding needs while at the same time raising the costs and the uncertainty of term funding. In response, the Bank of Canada has made significant efforts to support liquidity in financial markets.

Our actions aimed at stabilizing the Canadian financial system since the global crisis began 18 months ago have been unprecedented and significant. The Bank of Canada has moved aggressively by expanding the provision of term purchase and resale agreements (PRAs) to a total of $41 billion at its peak in December, and $35 billion currently. Term PRAs provide liquidity to key market participants for terms of up to three months against a wide range of securities. The Bank has widened the range of assets that it will accept in these operations and has extended the range of counterparties with whom it will transact. We also introduced a new Term-Loan Facility for those financial institutions that participate directly in the Large Value Transfer System, taking their non-mortgage loan portfolios as collateral. Last week, the Bank announced a new term PRA facility for private sector instruments that expands on the private sector term PRA facility that we set up last autumn for money market instruments. The facility is opened to a broader range of participants, against a broader range of eligible securities, and it is available for a longer term and at a lower minimum bid rate. The liquidity from this new facility should provide indirect support to credit growth in Canada by improving secondary-market liquidity and increasing demand for corporate securities.

I would like to point out that these facilities have been financed, not by expanding the supply of central bank money to the financial system, but rather through the sale of treasury bills, either from the Bank's own portfolio or from new issues whose proceeds are in turn held on deposit at the Bank of Canada. I would also note that, on a consolidated basis, the Government of Canada earns net income from these operations, represented by the spread between the yield on our own term PRAs and by the yield on treasury bills. Furthermore, there is little risk to the taxpayer in these operations, as we require participants to pledge a greater amount of collateral than the amount of money borrowed.

These liquidity operations have resulted in a significant reduction in spreads at the short end of the market. CDOR-OIS spreads have narrowed substantially since last fall, when conditions were extremely negative. Improvements are especially notable at shorter maturities (such as 1-month) and are largely attributable to the liquidity facilities that have been put in place. Spreads at 3 months which peaked at about 125 basis points in Canada, are now close to more normal levels; that is, about 25 basis points.

While the Bank of Canada's liquidity operations are focused on short-term financing, the Government of Canada has introduced measures aimed at supporting long-term financing for businesses and consumers. Let me highlight two. One is the Insured Mortgage Purchase Program, which allows financial institutions to fund new financing by selling pools of insured residential mortgages to CMHC; another is the Canadian Secured Credit Facility under which the Business Development Bank of Canada will buy term asset-backed securities backed by loans and leases on vehicles and equipment.

All of these measures are helping to meet a rising demand from business and individuals who have been finding it difficult in this environment to raise adequate funds. We have all heard reports about ongoing tightening in both the availability and the pricing of credit. Nonetheless, our latest figures show continued strong growth in total household credit – 9.6 per cent in January compared with the same period one year earlier – and limited deceleration in growth of total business credit. The latter stood at 4.2 per cent in January compared with the same period one year earlier as accelerating growth in bank lending has helped to offset a contraction in market financing. We will continue to closely monitor credit growth and credit conditions in Canada.

In conclusion, as we are all very well aware, the Canadian economy is feeling the effects of the global turmoil and recession. Authorities have put a lot of fiscal and monetary stimulus in place – in Canada and globally – to support the recovery. However, as I noted at the outset, stabilization of the global financial system remains a precondition for the global and Canadian economic recoveries. Investor and public confidence has been badly shaken, but will recover with the timely implementation of ambitious plans in some major countries to address toxic assets and to recapitalize financial institutions. However, if these national and multilateral measures are not timely, bold, and well-executed, Canada’s economic recovery will be both attenuated and delayed.

I would now be pleased to answer your questions.