



# *Canada and the Current International Financial Crisis*

**WEBINAR**  
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*International Trade and Investment Centre*

# John Pattison





# ***“Never Waste A Good Crisis”***

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# Financial Crises - Background

- Paul Masson and I wrote *International Financial Policy Reform and Options for Canada* with the subtitle “Think Globally, Act Locally”. This was published by the Conference Board in February, although we had been writing it for more than 3 months. The financial world has continued to change since then.
  - The CB had suggested the subtitle and it carries an important message. We will come back to this later.
  - I mentioned the time to write the book deliberately. The facts and recommendations in the book stand up to the passage of time, and we believe will continue to do so. But the world is changing.
  - Some of our recommendations are not popular in some quarters but that is to be expected. We can talk about this later as well.

# Financial Crises - Background

- The world, Canada and this crisis, have continued to mutate. So while I will address our issues from the publication, I will also look at emerging issues and future risks.
- I should note that very little is new in this crisis. The crisis is however more complex and more broadly reaching. The products and markets are more complex but many of the issues remain those of 1929.
- One often unstated observation is that the world is much more vulnerable today than it has been for many years. How will the official sector respond to this? We can come back to this later.

# The Best Financial Crisis Ever

Notwithstanding the fact that the individual issues are well known, it is not hard to argue that this is the best financial crisis ever. It is:

- More complex: involves complex financial instruments, and aspects of the plumbing and accounting for advanced economies.
- Reflects more underlying weaknesses.
- Has spread internationally more than many crises.
- This crisis has destroyed wealth for many segments of economies, relative to previous crises.
- This crisis is uniquely a developed country crisis, whereas the preponderance of previous financial crises relate to emerging market countries. However it has spread to emerging markets.
- This crisis has seen new approaches to public policy responses. Many of these are dramatic departures.
- The international policy framework, the role of the International Monetary Fund, and others are in need of a serious rethink, something that has not happened since 1944-45.

# The Best Financial Crisis Ever

There are positive things that can come from crises and you don't want to miss opportunities for improvements, namely:"

- There are many aspects of financial markets that had become irrational and thus needed attention.
- Financial markets and instruments had become too complex, and needed to scale back to appeal to customers and to manage risks better.
- Many banks did not manage risks well or have a focus on their core businesses. They now understand this.
- There were global imbalances that were underpinning some of the financial flows that were involved in the crisis.
- Central banks and financial supervisors are re-equipping their toolkits and rethinking their activities.
- Federal and provincial governments have had to respond to a severe crisis. But such a crisis was always on the cards, only the timing was obscure. There are lessons here as we will discuss later.

# Digging Out

- No financial crisis follows straightforward paths, although history provides some interesting lessons. This crisis has seen unprecedented financial and fiscal stimuli and there is no historical evidence as to how they will impact the economy in what time frame. In the 1930s governments did little relative to today's response.
- Plumping the bottom of the crisis, and assessing the future path depends upon your perspective: unemployed, employed, banker, life company, investor, pensioner, central bank, government.
  - There is social and financial trauma from crises that will affect the lives and behaviour of Canadians and others for decades.
- Many of the policy initiatives, and the impact on public spending and deficits will take years to unwind, and will limit the future opportunities for all parties, particularly governments.
- It is the future impact that is probably not fully grasped at this time, and which needs assessment.

# What Did Canada do Right? (Accident or Good Luck counts)

- The bank leverage ratio helped. It doesn't exist in many countries, and bankers oppose it.
- Banks did not become so large that they did not manage risks well.
  - Many of the global banks that got into serious difficulty had made more than one major merger and had developed huge balance sheets.
- Bank supervision at OSFI was reasonable, and their quasi-independence helped them make better decisions over time (relative to some other countries.)
  - Being a financial supervisor is not an easy job and they have my sympathy at all times.
  - The regulatory framework, the information to act, the decision to act, the will to act are all tough decision points with opposing interest groups and impacts on the economy.
- Canada is a small country with a minor currency and thus it is particularly risky for Canadian institutions to fund large and complex international risks.
  - Iceland missed this lesson, but it is a very special case.
  - Austria, Belgium, Ireland, Sweden and others need to question how large an international financial system a small country can support.
- CMHC is better designed relative to the US Government Sponsored Enterprises (GSEs) such as Fannie Mae and Freddie Mac.
  - Our typical five year interest rate reset on mortgages prevents many financial mismatches and the generation of risks.
- Governments entered the crisis in better fiscal shape than many other countries (but not as well as many of our governments might have been when cycles are taken into account).

# Economic and Financial Vulnerabilities

- Governments have a large capacity to stabilize economies; but their ammunition is not unlimited.
  - We could see financial crises in major Western governments if the crisis drags on. Certainly a number will have their credit rating downgraded. The US, UK and European countries are in worse shape.
- There is a global shortage of demand: where will it come from?
- Banking sectors in many countries will be cautious, for very good reasons. This will limit the strength of recoveries.
  - Banks are also moving back to their commercial roots, away from investment banking, and are seeking to redefine their own strategies. This is occurring while the official sector is trying to decide how to regulate banks in the future.
  - Governments are trying to make financial markets less cyclical. How will this work? Could it make matters worse?
- Getting monetary policy back on track will be important. This may mean extracting the excess stimulus as well as raising interest rates significantly over the medium term. This is a well understood area. But that doesn't make its execution easy.

# Risks: If anyone needs more

- An additional crisis layered on the financial crisis (political, security, international, pandemic etc) would mean extending the slump.
- Inflation is seen as a significant future risk by many although it is not as clear to me. I believe it could be a serious risk and must be avoided.
  - But if it did happen, it will be built into future interest rates.
  - If it did happen it would take central banks 15 years of slow growth to repair the damage. They also know this.
- Governments have little or no room for manoeuvre in their public finances. Higher inflation would multiply the debt service costs by a large factor.

# Think Globally, Act Locally

- I mentioned our subtitle at the outset.
- There are two aspects worth considering:
  - The international institutional setting, and
  - The importance of getting domestic policy right, notwithstanding the need for international coordination.

# The International Institutional Setting

- International cooperation is a large and competitive industry. There are over 100 institutions and important committees or sub-committees. Forum shopping and choosing the right venue and membership is important.
- The institutional structure has not adapted to the change in the world.
- International institutions underperform and overlap both in membership and subject matter.
- The background is worth recalling.

# International Financial Institutions

- The IMF and World Bank were created at the end of the Second World War in unique circumstances, that could not be replicated to get a new international agreement today.
- The Bank for International Settlements which was created in 1930 has re-invented itself in a number of ways and its core committees are central to international financial cooperation.
- The OECD, European Union institutions, World Bank, regional development banks and others all play a role.
- The G2 has carried a lot of the freight, plus the G3 and G7, and now the G20, which means approximately G28.
- But these institutions did not identify the emerging crisis, the international transmission or coordinate policy responses.
- The policy responses were coordinated in many ways through central banks, finance ministries and other bilateral, and sometimes multilateral mechanisms.

# Domestic Policy

- While there is work to do in improving the international institutional framework, this must not distract attention from the critical but difficult domestic policy needs.
- These include fiscal policy, monetary policy and financial regulatory and supervision.
- As an example of the difficulties consider fiscal policy.
  - Especially for small countries such as Canada, the importance of foreign demand for domestic output, plus the leakages into imports and savings make designing federal or provincial stimulus packages more difficult.
  - Moreover it is easy to waste scarce fiscal capacity in a small country while causing a deterioration in credit worthiness of governments while creating modest domestic benefits if foreign demand remains low.
  - This is more important if the crisis drags on.
- So getting domestic policy correct, but in the framework of complex international interdependencies, is the first and most important job.

# Moving Forward: Tracking

- We are not out of the woods on this crisis. We need to track
  - the crisis and its evolution, victims, collateral damage and, hopefully, the exit to stability.
    - The reason for close tracking is to avoid compounding management and policy challenges in this complex environment.
  - Track the policy environment:
    - Fiscal policy at all levels in Canada (and other countries)
    - Monetary policy and tools.
    - Financial regulation and supervision (keeping in mind international norms are minimums.)
    - The reason is that, in the international situation, fiscal deficits can be badly designed or wasted. Monetary policy may need to reverse the stimulus quickly to prevent inflation.
- This is an area where the Conference Board can help.

# Concluding Comments

- This has been an unparalleled and complex crisis.
  - But remember that the underlying financial and economic developments are not new, we understand the problems and the analysis needed.
  - So the challenges for governments, corporations, individuals at all levels are probably well understood. That is cold comfort, but it is some comfort.
- Many groups do not like change:
  - So watching the evolution of government policy in coming years will be important for all concerned.
  - Securitization is an example. It is critical to finance many parts of the economy, but the process is broken. Some sensible policy responses, notably in Europe are not popular with the industry. (These are sensible because they are similar to a recommendation we made!)
- The macroeconomic outlook is far from clear particularly given international imbalances: the US consumer and US governments need to increase savings and improve their balance sheets. But if they do, where will the demand come from in coming years?
- But the worst potential outcome from this crisis would be to not learn from it. That is the political and economic challenge of the highest importance.

## *Questions and Discussion*

# Stephen Poloz

## Export Development Canada



# Export Development Canada

## *Managing Through the Credit Crisis*

Presentation for  
International Trade and Investment Centre  
May 12, 2009 Webinar

Stephen Poloz  
Senior Vice-President, Financing  
Export Development Canada

## What is EDC seeing?

- **Exporter perspective:**
  - Seeing declining sales in most sectors
  - Banks increasingly reluctant to margin (monetize) receivables
  - More difficult to support advance payment/performance obligations (bonding)
  - Bank credit policies being tightened; credit lines being held
  - Refinancing more difficult and costly to obtain
  - Non-traditional lenders are exiting the space
  - Credit insurers are pulling cover for domestic and foreign receivables
  - Foreign banks matter, too:
    - Example: Icelandic banks have been supporting Canadian fisheries, and they are going through their own restructuring
    - Foreign buyers are facing similar financial challenges with their banks – and this is a further drag on Canadian export opportunities
    - Foreign lending institutions reducing their presence in Canada – need to conserve capital and focus on home markets (e.g. ING selling some of its Canadian operations)
- **From the perspective of Canadian banks:**
  - Facing difficulties with funding, paying higher costs
  - Existing loans are deteriorating in quality
  - Writing new business where non-traditional lenders have vacated

## EDC Response: Stay the Course

- **Managing an existing book as it steadily becomes riskier**
  - Over \$25 billion in loans on the books already, many of which could be downgraded and absorb more capital, may require restructuring, etc.
  - Other contingent liabilities (insurance) amount to another \$25 billion
  - Over 25% of EDC's volume is in emerging markets
- **Continuing to use EDC's existing suite of solutions**
  - Developing new trade for Canadian companies in strategic foreign markets
  - Leveraging our network of domestic and foreign partners, including BDC
  - Engaging with companies one-on-one to address specific needs
  - Continuing to issue credit insurance (insure exporters get paid)
  - Continuing to do financing (for foreign buyers, pre-export financing, etc.)
  - Continuing to do bonding (e.g., facilitate exporter performance requirements)
  - Continue to do political risk insurance (cover Canadian foreign investments)
- **Staying the course in this riskier environment is becoming very capital- and labour-intensive**
- **Continue to leverage our relationship with DFAIT and the Trade Commissioner Service**
- **Partnering with BDC, CCC, DFAIT to coordinate program service delivery**

## EDC's Expanded Role in Supporting Canadian Companies

- Measures in the Federal budget have broadened EDC's ability to better support Canadian companies through the crisis
  - Authorized capital limit raised from \$1.5 bn to \$3 bn
  - Contingent liability limit raised from \$30 bn to \$45 bn
  - The Canada Account portfolio limit will be raised from \$13 bn to \$20 bn
- EDC undertaking domestic financing and insurance for a two-year period as a temporary measure
  - Complement activities by Canada's banks during the credit crisis
  - Focus on partnering with banks, providing guarantees
- EDC and BDC will jointly provide up to \$5 bn in loans at market rates in partnership with Canada's banks under a newly created Business Credit Availability Program (BCAP)
- EDC will work in partnership with domestic sureties, banks, and customers to bring additional bonding capacity to the market that is complementary and provides incremental capacity.
- Private insurers and EDC have reached an agreement in principle on a domestic reinsurance concept, whereby EDC provides credit insurance capacity for domestic receivables to private insurers, which then distribute this capacity to their customers. Under this agreement, risk sharing would be on a 50:50 basis.

## How will companies respond?

- Strategies will vary from company to company
- But in general, the pressures to globalize have never been greater
  - Competitive pressures increase during a generalized downturn
  - All the global growth will be in emerging markets
  - Sticking with traditional markets will mean declining sales
- And the world is operating according to a new trade paradigm...
- Large companies are revisiting all aspects of their global production and supply chains – an opportunity for Canadian SMEs to integrate themselves into newly transformed production networks
- EDC has the tools necessary to facilitate the whole integrative trade paradigm

## EDC's Core Business is Solid

<b>Business Facilitated in 2008</b>	\$85.8 billion
→ In Developing Countries	\$21.9 billion
→ On behalf of SMEs	\$17.8 billion
→ <i>More than 50% of transactions in partnership with other financial institutions</i>	

### Benefits to Canada (2008)

→ Contribution to Canada's GDP	4.4%
→ Employment sustained	572,000 person-years
→ Every transaction must satisfy a Canadian benefits test	

<b>Business Facilitated in 2009Q1</b>	\$17.4 billion
→ In Developing Countries	\$4.4 billion
→ On behalf of SMEs	\$3.2 billion
→ 6,931 customers served, up over 8% from 2008	

## *Questions and Discussion*

# Upcoming Publications

- The Perfect (Anti-Trade) Storm? Recession, the November U.S. Elections, and What it All Means for Canada, Mark Busch (just released)
- Volatility in the Canadian Dollar: Who Takes the Hit? (June)
- Big Gains With Small Partners - What MNCs Look for in Their SME Suppliers (June)
- Seizing the Future: Time to Rebook Canada's Approach to International Trade & Investment

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