

Canada modestly impacted by European debt crisis so far, Bank of Canada says

MONTREAL — While the European debt crisis has only had a “modest” impact on Canada, the crisis isn’t over and all governments need to be on healthy fiscal paths, Bank of Canada governor Mark Carney said Thursday.

“So there’s been a modest impact on financial conditions — a slight tightening of financial conditions in Canada — and a modest impact on commodity prices,” Carney said at a news conference.

“But it’s not over. You know, this is serious stuff,” he said, adding that it is “incredibly important” to execute the right policies to deal with the situation.

The head of Canada’s largely independent central bank has been providing similar advice to policymakers for months. His latest speech comes as Canada prepares to play host to G20 and G8 meetings from June 25 to 27, when the state of the world’s financial system will be among the main topics.

Canada won widespread accolades during the 2008-09 credit crisis and recession, for a regulatory regime credited with avoiding problems that forced the United States and other governments to bail out major banks and insurance companies.

Carney said he’s encouraged with the measures that European policymakers have taken so far, “but I don’t think anybody is of the view that more will not be required.”

“What we are seeing at present is a stronger demand from the market for more credible plans, more rapid plans, more rapid movements to fiscal sustainability at any level of government.”

BMO Capital Markets senior economist Michael Gregory said Carney’s remarks suggest the Bank of Canada has room to raise its key rates in July — following a quarter-point hike this month.

The central bank’s policy rate had been set at an all-time low of 0.25 per cent last year as a means to ease the cost of borrowing in order to stimulate the economy out of the deepest recession in decades.

“Bottom line: It sounds like the urgency of the risks posed by the European situation has eased somewhat in the Bank of Canada’s mind,” Gregory wrote in a note.

“Other things equal, this modestly raises the odds of a followup rate hike on July 20.”

Carney wouldn't say if another hike in the central bank's policy rate is expected this summer. On June 1, the Bank of Canada raised its key rate a quarter point to 0.5 per cent, the first time in almost three years.

"I would say it's too early to make a judgment, nor is it necessary for us to make a judgment today."

This week, the World Bank raised the possibility of a second recession affecting most of the industrialized world if governments don't deal successfully with the unfolding European debt crisis affecting such countries as Greece and Spain.

The risk is serious enough that it will likely be the key topic of discussion for leaders meeting in Toronto later this month at a G20 summit.

During his speech to a Montreal economic conference, Carney said that banks should prepare for radical reforms to the world's financial system that will make it look a lot more like what's already in Canada.

The Canadian banking sector has been held as an example for the international community because its conservative investment practices helped it endure the credit crisis in 2008.

"The rigour of Canadian capital regulation was an important — although far from exclusive — reason why the Canadian system fared so well during the crisis," Carney told the International Organization of Securities Commissions.

And he stressed that reforms pose no threat to the global recovery, saying the opposite is true — they will help economic growth.

Once implemented, global financial institutions will be required to retain more and better capital, improve liquidity and reduce risk, and introduce a capital buffer that is sufficiently large to absorb losses encountered in the 2008 crisis that led to a global recession, Carney said.

Although the coming changes will be significant, Carney dismissed critics who believe the requirement for more capital reserves will limit banks' ability to lend and slow down economic activity.

In fact, the opposite will happen, he said.

The reforms will cause banks to shift focus away from trading risky financial instruments and more to conventional lending to businesses and individuals that spur growth, he argued.

And he noted that banks will be given plenty of lead time to meet new standards since the implementation date of key reforms won't be until the end of 2012.