Report to Shareholders

Canadian Commercial Bank

Operating Environment

It is anticipated that Canada and the United States will close 1984 with respective Gross National Products showing real growth of 4.5% and 7.0%. While this traditional indicator of national economic well-being is favorable, it unfortunately masks the ongoing distress in some regions and sectors. Primarily driven by the performance of the automotive industry, this welcomed sign of recovery is diminished for the resource-based economies of Western Canada which remain in the doldrums because of continuing soft demand and pricing for most commodities. In addition, high interest rates and deflationary forces have worked to the disadvantage of the energy, forestry, mining, agricultural and real estate industries in this region.

While the economies of Alberta and British Columbia had expanded well above the national average until 1981, the subsequent period has been marked by a sharp and sudden reversal. Retail sales for the nine months to September 30 advanced only 2.1% in Alberta and 5.1% in British Columbia compared with the national average of 8.8%. Annual urban housing starts for the same period declined 62.4% in Alberta and 20.8% in British Columbia following severe declines of 43.3% and 1.7% respectively in 1983. The average Canadian growth rate in housing starts for 1983 was 27.0% and a decline of 19.1% for the initial nine months of 1984. Unemployment in Canada, which remains at a distressed level of 11.3%, compares favorably with levels of 11.8% in Alberta and 15.1% in British Columbia.

The effect of this economic climate on the Bank was heightened during 1984 by unsettled financial markets. The interbank market, historically CCB's major source of U.S. dollar deposits, was shaken by the near-collapse of one of the largest U.S. banks and volatile operating results reported by other major U.S. banks. In the wake of large domestic loan losses, U.S. government regulators placed more than 800 of 15,000 banks on their list of problem banks, while the number of outright failures rose to post-depression record levels. During this same period there has been increasing concern regarding the soundness of massive international loans, particularly to underdeveloped countries and debt-burdened Latin America.

These conditions encouraged many depositors to migrate towards government issues and the facilities offered by the largest financial institutions to the detriment of the deposit raising activities of smaller institutions such as Canadian Commercial Bank.

Through this period, escalating government deficits in Canada and the United States, combined with defensive monetary policies and uneasy financial markets, produced high interest rate levels. In the June to August period rising demand for business and consumer credit drove the Canadian prime rate to a peak of 14%. While prime rates have subsequently declined by 200 and 150 basis points in Canada and the U.S. respectively, they continued higher on average by 43 and 109 basis points in fiscal 1984 compared to 1983.

The existence of high interest rates coupled with the lowest levels of inflation in more than a decade have produced unprecedented high real interest rates. The prevailing spread between prime rate and the inflation rate in Canada is in excess of seven hundred basis points whereas historically this spread has been in the range of three to four hundred basis points. High real interest rates have prevented many borrowers, still reeling from the effects of the 1981-82 recession, from materially improving their financial position on the strength of the recovery.

While CCB is not a regional Bank, its performance will continue to be adversely affected by a prolonged economic recession in Western Canada. The energy sector has been under pressure since 1981 when conservation and fuel switching, coupled with a global recession and the National Energy Program in Canada, almost overnight changed the world's perception of oil supplies from shortage to glut and brought a decade of unprecedented growth to a sudden halt. The prognosis for the Canadian petroleum industry began to improve during the latter stages of 1984 when the introduction of market pricing led to new natural gas export contracts. Tax and royalty concessions have generated renewed interest and important investments in heavy oil and tar sands projects. The Federal Government's commitment to