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The Financial Crisis and Canada

Financial market stress intensified and reached a junction in the early autumn months of 2008. The failure of Lehman Brothers was the turning point: it transformed the financial turmoil that began in August 2007 into the largest financial shock since the Great Depression, inflicting heavy damage on markets and institutions at the core of the financial system. The turmoil was initiated by rapidly rising defaults on subprime mortgages in the context of a major U.S. housing correction and the consequent blowout in spreads on securities backed by such mortgages, including on collateralized debt obligations structured to attract high credit ratings. The fallout rapidly spread through an excessively leveraged financial system to weaken capital adequacy, curtail liquidity, drive up the costs of borrowing, and force bankruptcy, conversion or bailout of major financial institutions. Asset values have fallen sharply across advanced and emerging economies, prompting households and businesses to postpone expenditures, thereby reducing demand for consumer and capital goods, curtailing production and trade around the world, and precipitating a global recession.

As financial shock after financial shock accumulated, the economic outlook began deteriorating over the fall, with bad economic news following bad economic news. Evidence began to pile up that major economies were entering or were already in recession. At the start of December 2008, the National Bureau of Economic Research, the official arbiter of U.S. business cycles, announced that the world's biggest economy had slipped into recession in December 2007. In the second half of 2008, the U.S., Japan and the euro-zone moved into technical recession (defined as two consecutive quarters of negative growth), the first such synchronized decline since the Second World War. Expectations are that the global economy will be in recession (defined as less than 3% growth) in 2009, with the International Monetary Fund predicting that world economic output will contract by 0.5% for the year. Most major economies have implemented some type of economic stimulus package to help bolster domestic demand and stimulate economic activity.

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