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SHANGHAI GM RELATIVELY IMMUNE FROM GM FINANCIAL WOES, BUT NOT FROM CHINA'S ECONOMIC SLOWDOWN

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1. (sbu) Ref a requested information regarding Post's outlook on the continuing impact of the economic and financial situation on Canada, as well as Canada's expected priorities and objectives for the London G-20 Summit on April 2. Econcouns John Carwile (carwilejl@state.sgov.gov) and EMIN Eric Benjaminson (benjaminsoned@state.sgov.gov) are post's primary points of contact in the run-up to the Summit.

2. The following points are keyed to ref a's inquiries:

Summary of Key Issues

-- STIMULUS: WHAT HAS BEEN PROPOSED THUS FAR? WHAT MORE IS BEING CONSIDERED? IS THERE CAPACITY TO IMPLEMENT CURRENT AND POTENTIAL FUTURE MEASURES?

Canada,s budget -- likely to be approved by Parliament in March -- provides massive (by Canadian standards) fiscal stimulus measures. The government's budget provides C\$40 billion in stimulus over two years focused on infrastructure, tax breaks, and targeted assistance for vulnerable groups and individuals. (Ref b) According to Finance Minister Flaherty, this "Economic Action Plan provides stimulus this year (2009) which, with our provincial and territorial partners, amounts to about 1.9 percent of GDP, and next year about 1.4 percent of GDP."

The Bank of Canada has also tried to provide monetary stimulus to Canada,s economy, cutting its benchmark lending rate by 400 basis points to 0.50 percent since December 2007. (Ref c) The latest Bank cut of 50 basis points came on March 3. With its benchmark rate near zero, the Bank is open to providing further monetary stimulus "through credit and quantitative easing."

-- FINANCIAL SECTOR: WHAT HAS BEEN THE APPROACH TO RESOLVING BAD ASSETS: RING FENCING, INJECTION OF CAPITAL, NATIONALIZATION? ON REGULATION: WHAT CHANGES, NATIONAL OR SUPRANATIONAL REFORMS ARE BEING IMPLEMENTED OR CONSIDERED?

Canada,s banks have relatively little exposure to so-called &toxic debt.8 In late 2008, the World Economic Forum ranked Canadian banks as the world,s healthiest. No Canadian bank is anywhere near collapse. Canada,s regulatory oversight has strict reserve and capital requirements -- and banks are well-capitalized. Canadian investment banks are part of retail banking -- and brokerages meet regulatory requirements pertaining to retail banking. Canadian banks carry a small percentage of sub-prime mortgages (five to six percent of the Canadian mortgage market in 2008 was sub-prime; banks hold some 75 percent of



Canadian mortgages). (Ref d)

The federal government and the provincial governments of Alberta, Ontario, and Quebec agreed to support a restructuring plan for non-bank sponsored, asset-backed commercial paper. Beyond this, no substantive reforms are being considered for the Canadian financial sector.

REAL ECONOMY: HAVE SENSITIVE AND VULNERABLE SECTORS BEEN IDENTIFIED AND PROTECTED? IF SO, BY WHAT MEANS? HAS CANADA COMMENTED ON WTO COMMITMENTS? WHAT IS THE TENOR OF GOVERNMENT AND PUBLIC DISCUSSION REGARDING PROTECTIONISM?

In addition to the federal budget,s stimulus plan, the federal government and Ontario province have announced a joint C\$4 billion plan for Canada,s automotive sector worth 20 percent of the U.S. automotive aid package. The U.S. and Canadian automotive sectors are highly integrated. The Canadian arms of General Motors and Chrysler plan to take advantage of the Canadian aid, while Ford) for now) has decided not to draw on the government funds. The automotive industry is the largest segment of Canadian manufacturing, and 85 percent of its output is destined for the United States. (Ref e)

Prime Minister Harper and other officials have expressed strong concern that protectionism could grow as the global financial crisis continues, threatening a spiral down into a global depression and undermining progress toward addressing the crisis. The Canadian government and the general public both criticized the &Buy America provisions in the February U.S. economic stimulus legislation and warned that it could spur global protectionist measures. (Refs f, g) Recent developments regarding the U.S. Department of Agriculture's side letter on Country-of-Origin Labeling (COOL) were lumped into an overall "protectionist" rubric, along with "Buy America" by the Canadians.

-- SOCIAL/LABOR IMPACT: WHAT STEPS HAVE BEEN TAKEN TO ADDRESS AN INCREASE IN UNEMPLOYMENT? HAS CANADA EXTENDED OR PROVIDED NEW BENEFITS TO ASSIST THE UNEMPLOYED? HOW IS THIS BEING FUNDED? WHAT IS THE LEVEL OF PUBLIC PROTEST RELATED TO THE ECONOMIC CRISIS AND GOVERNMENT RESPONSE?

The federal government has improved access to unemployment insurance benefits by making them more broadly available and for longer durations. Canada has also established special Qfor longer durations. Canada has also established special funds for single-industry towns or other regions disproportionately affected by the crisis. The federal budget also provides a wide range of social spending initiatives aimed at lower- and middle-income Canadians.

-- DIMENSION OF THE CRISIS: WHAT ARE THE CONCERNS REGARDING SCOPE AND DURATION OF THE CURRENT ECONOMIC SITUATION? WHAT



ARE VIEWS ON THE IMPACT ON EMERGING MARKETS? WHAT IS THE EXPOSURE OF CROSS-BORDER FINANCIAL INSTITUTIONS? HAVE ANY PROPOSALS BEEN PUT FORWARD TO ASSIST SUCH MARKETS AND INSTITUTIONS?

Canada's economy is dependent on improved prices for commodities (energy, agriculture, forestry, and mining) and an upturn in U.S. demand for Canadian exports. Canadian government officials emphasize that stabilization of the global financial system remains a precondition for Canadian economic recovery. They believe that the timely implementation of ambitious plans in some major countries to address toxic assets and recapitalize financial institutions will be critical in this regard.

Recently, Canada has paid greater attention to investment opportunities in emerging markets, particularly in Latin America, through expansion and/or fuller utilization of government-sponsored lending through the Export Development Corporation. Canadian institutional investors, however, are not expected to acquire high-risk emerging market assets because lower-risk assets in G-7 countries are available at relatively low prices.

About a third of the profits of the six main Canadian banks came from operations in the United States and emerging markets in Latin America and the Caribbean in 2007. Four banks reported profits in the first quarter of 2009, and those with smaller U.S. credit portfolios performed the best. Recently, some Canadian banks have complained about competing for U.S. assets with American banks that have received TARP funds.

-- ROLE OF THE G-20: HOW IS THE G-20 PROCESS VIEWED? WHAT IS THE LEVEL OF SUPPORT FOR THE PROCESS? HOW IS THE G-20 PROCESS SEEN IN TERMS OF OTHER MULTILATERAL PROCESSES AND GLOBAL ECONOMIC ARCHITECTURE?

Canada is supportive of and active in the G-20 process, seeing itself as a credible leader for greater regulation and transparency (while opposing more "creative" calls to wholly rewrite global financial structures.) Canada has a degree of ambivalence about the G-20 itself, however. On the one hand, Canada realizes that the size, complexity, and impact of the financial crisis requires the participation of economically important countries outside the G-7 (e.g., Brazil, China, India). However, Canada is also aware that the G-20 can have difficulty achieving and maintaining consensus on important issues. Canada believes that the G-7 is a more efficient, like-minded grouping) and may at some point need to forge its own consensus and lead any G-20 approach.

SPECIFIC QUESTIONS:

I. OBJECTIVES FOR THE LONDON SUMMIT:



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A. IN THE RUN UP TO THE LONDON SUMMIT, WHAT ARE THE ISSUES OF GREATEST IMPORTANCE TO CANADA?

In general terms, Canada wants to help stabilize the international financial system and create greater transparency, which will lead to greater confidence and lending. The Bank of Canada -- which often complements government actions and policy statements -- stated on March 3 that "stabilization of the global financial system remains a precondition for the global and Canadian economic recoveries. The timely implementation of ambitious plans in some major countries to address toxic assets and recapitalize financial institutions will be critical in this regard."

Prime Minister Harper has expressed his hope that the voices against protectionism will be loud at the (G-20) meeting.⁸ He believes that if countries erect protectionist barriers, it could plunge the world into a deep depression.⁸

B. BASED ON PUBLIC COMMENTS MADE BY CANADIAN OFFICIALS, WHAT ARE CANADA'S LIKELY OBJECTIVES FOR THE SUMMIT?

See D below.

C. ARE THERE DESIRED OUTCOMES THAT OFFICIALS HAVE IDENTIFIED PUBLICLY?

See D below.

D. BASED ON PUBLIC INFORMATION, WHAT RECOMMENDATIONS OR REFORMS MIGHT CANADA SUGGEST? FOR EXAMPLE, IS CANADA PROPOSING CHANGES TO INTERNATIONAL FINANCIAL ARCHITECTURE, REFORM OF INTERNATIONAL FINANCIAL INSTITUTIONS, OR ADVOCATING THE CREATION OF NEW INTERNATIONAL BODIES? IS CANADA PROPOSING ADDITIONAL REGULATION OF FINANCIAL PRODUCTS OR INSTITUTIONS, MAKING CHANGES TO EXISTING STANDARDS, OR ADVOCATING NEW BEST PRACTICES?

Canada wants the G-7 to remain central to global financial efforts and does not favor a wholesale reworking of international financial structures. It believes that the current structures, including the International Monetary Fund, could be put to better use. Finance Minister Flaherty has stated that in the middle of an economic crisis, synchronized global recession, a crisis in some of the financial systems of the world, this is not the time to create new global entities, which would take months to get up and running, if not years.⁸ Greater oversight and regulation is needed, however, and Canada believes that it has the international credibility to lead in these areas. Canada sees the relatively cautious Canadian model,⁸ which



includes tight regulation and relatively high capital requirements, as a viable way forward for countries. (Ref h)

Flaherty has also reiterated "five necessary steps that have to be taken...globally" once individual countries get "their own fiscal house in order:"

- 1) "regulating all pools of capital that rely on leverage, making sure the transparency requirements are in place and that those transparency requirements are the price of admission to the global markets;
- 2) "creating capital and liquidity buffers large enough to handle big shocks with strong balance sheets similar to the Canadian system;
- 3) "ensuring regulation looks at the system as a whole, not just individual institutions;
- 4) "making market infrastructure more transparent and resilient; and
- 5) "strengthening international cooperation, review and surveillance to create a better second line of defence."

Bank of Canada Governor Carney has stated that U.S. and European banks should bring their asset-to-capital ratio (leverage ratio) to the 20-to-1 levels of Canadian banks. The Bank of Canada has estimated that U.S. and European banks would need some \$1.2 trillion to do so.

II. IMPACTS OF THE GLOBAL FINANCIAL CRISIS:

E. WHAT ARE CANADA'S GREATEST FINANCIAL MARKET CONCERNS (PROVIDING MORE LIQUIDITY TO FINANCIAL INSTITUTIONS, DEALING WITH BAD ASSETS, INJECTING FRESH CAPITAL, IMPROVING HOUSING MARKETS, GUARANTEEING DEPOSITS, MAKING TRADE FINANCE AVAILABLE, ETC.)?

Given the relatively strong state of the Canadian banking sector, Canada,s greatest financial market concern is the state of the U.S. financial system. Prime Minister Harper stated on February 23 that &it is essential that the United States somehow stabilizes its financial sector. Because if we don,t stabilize the financial sector, in the United States and abroad, we will not turn this recession around.8

F. WHAT ARE THE MOST IMPORTANT IMPACTS ON CANADA'S FINANCIAL SECTOR (WHAT SPECIFIC FINANCIAL INSTITUTIONS HAVE FAILED, WHICH ONES HAVE HAD LIQUIDITY/SOLVENCY PROBLEMS, HAS DOMESTIC LENDING TO THE CORPORATE SECTOR BEEN AFFECTED, ETC.)?

The Canadian financial system is relatively strong and



well-capitalized. No major financial institutions have failed, although some insurance companies) including those with exposure or subsidiaries in the United States) have faced financial problems.

The government has expressed concern that banks are not providing enough credit to the private sector, but there is dispute over whether this lack of lending reflects a weak economy or a reluctance of banks to lend. The government has used the bully pulpit to encourage greater bank lending. In addition, the government has leaned on the OPIC-like Export Development Canada (EDC) to increase its export-related lending even to established blue-chip firms.

G. WHAT INITIATIVES HAS CANADA TAKEN IN RESPONSE TO THE FINANCIAL CRISIS (HAS THE GOVERNMENT RESCUED FINANCIAL INSTITUTIONS, PROVIDED CAPITAL INJECTIONS OR CREDIT LINES, CHANGED ITS DEPOSIT INSURANCE GUARANTEES, ESTABLISHED ASSET PURCHASE PROGRAMS, TRADE FINANCE, ETC.)?

In late 2008, Canada took a number of steps in response to the financial crisis:

-- The Bank of Canada offered to provide up to C\$20 billion in liquidity to banks and broadened the range of collateral that the Bank will accept.

-- The Bank of Canada and the Federal Reserve instituted a reciprocal currency arrangement (currency swap facility) of US\$30 billion, if needed, to maintain USD liquidity in the Canadian financial institutions. To date, the Bank of Canada has not needed to use the arrangement.

-- Finance Canada announced that it would buy up to C\$25 billion in insured mortgages through the Canadian Mortgage and Housing Corporation to provide Canadian banks with cash with an aim to maintain the availability of longer-term credit for consumers, homebuyers, and businesses.

-- Finance Canada established the Canadian Lenders Assurance Facility to federally insure private interbank lending -- as long as the debt has at least a three-month term. The Facility will expire on May 1, 2009. Participating financial institutions will pay a base fee of 1.35 percent, plus a surcharge ranging from 25 to 50 basis points, depending on their credit ratings. (Canada's action parallels steps taken by other countries to guarantee loans, and is designed to keep Canadian banks competitive in the international lending market.) (ref i)

-- Canada has decided (so far) not to increase the C\$100,000 federal insurance on deposits in Canadian banks.

III. THE BROADER ECONOMIC CRISIS



H. WHAT ARE THE MOST IMPORTANT IMPACTS ON CANADA'S REAL ECONOMY? WHAT STEPS HAS CANADA TAKEN TO MITIGATE THE EFFECTS OF THE CRISIS?

According to Statistics Canada, 2009 fourth quarter figures show Canada's real GDP falling by 0.8 percent, the largest quarterly decline since 1991. Corporate profits were down 20 percent after seven years of upward trends. Fourth quarter results also showed declines in plant and equipment investment and construction, as well as widening inventory-to-sales ratios, especially in the automotive, petroleum, and agriculture sectors. (The auto sector, which usually has inventories equivalent to 50-60 days, now has inventory levels approaching 80 days.) Consumer spending fell nearly one percent in the quarter, the first decline since 1995. On the trade side, total Canadian exports fell 4.7 percent in the fourth quarter, the sixth consecutive quarterly decline. Goods exports were down 5.3 percent, with quarterly decline. Goods exports were down 5.3 percent, with automotive exports falling 19 percent.

Canada's broad-based fiscal stimulus focuses on infrastructure and social spending to until global demand for Canadian commodities and manufactured goods returns. The Bank of Canada is also using deep cuts to benchmark interest rates to stimulate lending.

I. WHAT HAS BEEN THE IMPACT ON TRADE, TRADE FINANCE, AND EMPLOYMENT IN EXPORT-ORIENTED SECTORS? ARE THERE PROBLEMS FINANCING EXPORTS AND/OR IMPORTS? IF SO, IN WHICH SECTORS? HOW IS CANADA ATTEMPTING TO ADDRESS THESE PROBLEMS?

The United States is Canada's largest trading partner, and slumping U.S. consumer demand has hit Canada particularly hard.

The energy sector (the backbone of the Canadian economy) has also been hard hit by weak oil prices. While there are still marginal returns in energy extraction and natural gas distribution, energy support activities and pipeline distribution reported losses in December. The energy sector as a whole fell 0.7 percent in the fourth quarter of 2008.

Unemployment rates are increasing across Canada, but are particularly high in the trade-dependent manufacturing sector in Ontario. Unemployment rates are also rising in the energy-focused provinces of Alberta and Saskatchewan, albeit after years of an energy-related employment boom.

Trade finance opportunities continue to be strong through the government's Export Development Corporation as well as the Business Development Corporation. The 2009-2010 budget added to the funds available through these institutions.



Canada is sensitive to its trade-dependent status and is avoiding any trade-distorting policy measures. A number of targeted tariff reductions have been announced including on imported industrial and agricultural inputs.

J. HOW HAS THE CRISIS IMPACTED CANADA'S OUTLOOK ON TRADE AND INVESTMENT? HAS THERE BEEN A PERCEIVABLE SHIFT IN HOW THE GOVERNMENT AND POPULATION VIEW THE BENEFITS OF INTERNATIONAL TRADE? ARE POLITICAL PRESSURES GROWING FOR PROTECTIONIST POLICIES? ARE MEASURES BEING TAKEN OR CONTEMPLATED THAT WOULD IMPOSE COSTS ON OTHER COUNTRIES IN AN ATTEMPT TO MEET DOMESTIC NEEDS (E.G., TARIFF HIKES, IMPORT LICENSING OR OTHER TRADE RESTRICTIONS ON, OR DISCRIMINATION AGAINST, FOREIGN INVESTORS)? IS CANADA CONSIDERING CAPITAL CONTROLS? ON THE OTHER HAND, IS CANADA CONSIDERING EASING INVESTMENT RESTRICTIONS IN AN EFFORT TO ENCOURAGE FOREIGN INVESTMENT?

The government and the public continue to be strongly supportive of free trade. There is no discernible pressure growing for protectionist measures, and no measures are being contemplated for tariff hikes, import licensing, or other trade restrictions.

Canada opposes capital controls.

K. DO FINANCIAL SECTOR/INDUSTRY BAILOUTS OR STIMULUS PACKAGES HAVE LOCAL PREFERENCES? IS THE GOVERNMENT ACTING TO INFLUENCE THE VALUE OF ITS CURRENCY (FOR EXAMPLE, TO IMPROVE EXPORT COMPETITIVENESS)?

Canada's fiscal stimulus budget does not contain local preferences. As previously noted, Canada's auto rescue plan is directed solely at the Canada-based subsidiaries of the Detroit Three, and complements Washington's efforts for the U.S. car companies.

The Bank of Canada's interest rate cuts) along with the worldwide drop in commodity prices) has contributed to the Canadian dollar's fall against the U.S. dollar. The Bank's motivation has been monetary stimulus.

IV. OUTLOOK AND POLITICAL/FOREIGN POLICY RAMIFICATIONS

L. HOW HAS THE OUTLOOK FOR GROWTH, INFLATION, THE CURRENT ACCOUNT, EXCHANGE RATES, AND THE BUDGET DEFICIT CHANGED? WHAT ARE THE BIGGEST ECONOMIC CHALLENGES FACING CANADA IN THE COMING MONTHS AND YEARS? HOW IS THIS CRISIS EXPECTED TO AFFECT EMPLOYMENT?

Canada's greatest challenge is largely out of its hands: the resuscitation of the U.S. (and to a lesser extent, the global) economy. Given the Canadian economy's relatively



small size and outward orientation, government and Bank of Canada stimulus actions can do little to promote recovery, other than make marginal improvements and provide some protection until export demand returns. Since the United States absorbs more than 80 percent of Canadian goods exports, Canada economic prospects are directly tied to recovery in the United States. Conversely, it is worth noting that Canada has a domestic market of 30 million wealthy consumers.

M. WHAT ARE THE POTENTIAL POLITICAL RAMIFICATIONS FOR CANADA? HOW MIGHT THE CRISIS DIRECTLY IMPACT LEADERSHIP? IS A CHANGE OF GOVERNMENT A POSSIBILITY? WHAT ARE THE SOCIAL AND SECURITY RAMIFICATIONS OF THE CRISIS?

The economy has emerged as Canada's central political question. The worsening economy will make the Conservative Party's minority government's hold on power increasingly tenuous and heighten prospects that the opposition Liberal party will seek to bring down the government and come into power in a federal election some time over the next year. At this point, however, the Liberals' own prospects of winning a genuine majority are also limited. In any scenario, a change in Canada's political leadership will be peaceful, democratic, and orderly, without social unrest or internal security concerns. Crime is increasing, in some part due to economic conditions, with all political parties willing to support tougher anti-crime legislation.

N. HAS CANADA CRITICIZED AND/OR BECOME SIGNIFICANTLY MORE QN. HAS CANADA CRITICIZED AND/OR BECOME SIGNIFICANTLY MORE CRITICAL OF THE UNITED STATES FOR ITS ROLE IN THE CRISIS OR FOR PROVISIONS IN THE U.S. ECONOMIC STIMULUS PACKAGE (SUCH AS THE "BUY AMERICAN" PROVISION)?

As mentioned above, the Canadian government and the general public both criticized the &Buy America provisions in the February U.S. economic stimulus legislation and warned that it could spur global protectionist measures. (Refs f, g) That said, Canada openly recognizes that its economy is largely integrated with (and dependent upon) the United States. Canada places a high value on its coordination and cooperation with the United States on economic matters, from stimulus measures to climate change.

O. HOW MIGHT THE CRISIS AFFECT CANADA'S FOREIGN OR SECURITY POLICY AND U.S. INTERESTS?

The crisis has reinforced Canadian awareness of Canada's close relationship with the United States. The crisis has not significantly affected overall foreign or security policy, or U.S. interests in Canada. Canada will look to continue its close coordination with the USG in the G-20, and may have some concerns about a potentially diminished role for the G-8, which Canada will chair in 2009-2010.



P. HOW MIGHT THE CRISIS IMPACT CANADA'S ABILITY AND COMMITMENT TO SUSTAIN FOREIGN ASSISTANCE LEVELS?

Canada has, for other policy reasons, restricted the focus of its foreign assistance to 20 priority countries. It has not cut its overall assistance levels.

Q. HOW MIGHT THE CRISIS IMPACT CANADIAN SUPPORT FOR GLOBAL PEACEKEEPING OPERATIONS AND COMMITMENTS TO NATO OPERATIONS, E.G., IN AFGHANISTAN?

Canada's commitment to its role in Afghanistan, including combat troops through 2011, remains firm. Canada will continue to attach importance to participation in other UN peacekeeping missions, especially in Haiti.

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