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## Part I: The Canadian Economy

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# Big Five banks near the edge of the cliff

by Richard Freeman

By autumn, Canada may have its most spectacular bank failure since the 1930s. The Canadian Imperial Bank of Commerce (CIBC) will probably collapse. As of the end of 1981, the CIBC had assets of \$66 billion Canadian or about \$52 billion American (\$1 U.S. equals \$1.28 Canadian), making it one of the largest banks in the world.

The gentlemen who run Canada's Privy Council—the real power in Canada, which makes decisions for Prime Minister Trudeau on behalf of Queen Elizabeth II—look toward a CIBC failure not as a domestic calamity, but as a lever to collapse the American banking system, should the Crown decide to go all the way with its plans to destroy the United States as a sovereign industrial superpower.

"A Canadian bank failure will spread like brush-fire to the U.S. and the rest of the world," stated Richard Coughlin, editor of the Toronto-based investment newsletter *Bank Credit Analyst*, one of the leading Anglo-Canadian think-tank operations. Coughlin confirmed that Canadian banks have borrowed \$25 to \$50 billion from American banks on the interbank market. Chase Manhattan, Citibank, Bank of America, and so forth, made three- to six-month loans to Canada's Big Five banks—Toronto Dominion, Royal Bank of Canada, Bank of Montreal, Bank of Nova Scotia and Canadian Imperial Bank of Commerce—or to their subsidiaries. Those banks account for no less than 90 percent of the assets in Canada's banking system. Were a major Canadian bank like CIBC to fail, its interbank loans would be in default. "The U.S. Federal Reserve Board would have to come in and bail out the mess," stated Coughlin.

The collapse of the Canadian banking system is already under way. On July 8, a member of the British Columbia provincial legislature announced on the floor of that body a rumor that CIBC was close to receivership. The next day, investors withdrew \$148 million from the bank. In Newfoundland, a large run started at the branches of the Bank of Nova Scotia was only quelled

when the bank's chairman issued statements assuring the public that the bank was sound. The chairman of the Royal Bank of Canada, Roland C. Frazee, sent letters to hundreds of branch managers instructing them on what to say to worried depositors.

### An overview

Canada is in the worst post-Depression debacle of any advanced-sector country. Every energy program and raw materials-extraction scheme to loot this territory—Canada is barely a nation—has failed. A quick survey of Canada's economy shows that it is in the midst of self-feeding collapse:

- The prime rate charged by banks is 18.6 percent; the rate on mortgages for homes is 19.75 percent; and the rate on three-month Treasury bills is 16.5 percent, as of the end of July.

- One and a third million Canadians were officially unemployed this June, out of a total labor force of 11,902,000. That is a 10.9 percent unemployment rate.

- The bankruptcy rate in Canada is two and a half times the U.S. rate for individual firms, and America's rate is the highest since 1933. Half of Canada's mines will be shut down by autumn. Thirty percent of the country's lumber industry is already idle.

- The value of the stocks on the Toronto Stock Exchange had fallen 42 percent, again comparing June 1982 with June 1981. Oil stocks had fallen by more than a third, wiping out \$11.5 billion in paper values. Bank stocks fell by 29 percent; transport 44 percent; real estate 46 percent. All told, the fall wiped out a nominal \$66 billion in stock holdings.

- Corporate profits in the first quarter of this year plunged 59 percent from the level of profits in the first quarter of 1981. And profits in the first quarter of 1981 had already fallen 25 percent from the first quarter of 1980. Of the top Canadian companies, 22 had outright losses and 34 had declines in profit in the first quarter of 1982.

- The Canadian dollar has been under severe attack—the Canadian government spent \$2.9 billion in June to try to stop its fall. But on June 28 the government announced a federal budget deficit for this fiscal year of C\$19.6 billion, which, were Canada the size of the United States, would translate to a U.S.\$200 billion deficit, or double the largest deficit that the Reagan administration has produced.

### The Big Five's bad loans

It would be remarkable if, with its industry withering under 18.6 percent prime interest rates, and the speculative natural resources' and real-estate side of the economy falling into oblivion, the Canadian banks could escape collapse.

The most likely to go is the Canadian Imperial Bank

of Commerce, as stated above. CIBC's immediate problem is a Dome Petroleum default on its more than \$1 billion in debts by September.

The Big Five Canadian banks have lent Dome \$4 billion. They only have \$9 billion in capital (stock value of their own banks, plus retained profits). Were Dome to totally default, half the capital of the Big Five—and they comprise 90 percent of the banking system—would evaporate. Of course some of these loans are secured against assets, but in a deflated oil market the value of such assets dwindles.

Dome is not exactly a special case. During the post-1978 period, when takeovers, financing, real-estate loans, and lending to oil firms went on at an increasingly frenzied pace, the Canadian banks were hardly examples of "prudent lenders." In July 1979, total loans made by Canadian banks to Canadian consumers and corporations totaled \$73.6 billion. This zoomed to \$120.6 billion, an increase of 64 percent, by November 1981. Since that time, under the monetarist regime of Bank of Canada chief Gerald Bovey, the level of loans has stagnated.

CIBC, in addition to its \$1.4 to \$1.8 billion in loans to Dome, made \$400 million in loans to Massey-Ferguson and \$500 million in loans to Turbo resources. Royal Bank of Canada made \$400 million or more in loans to Sulpetro oil. And so on.

The danger is not only that these and other loans will go bad, but that at a certain point, the Big Five banks will not have enough funds to cover their bad loans without calling back outstanding loans to other companies. This could also happen if depositors began withdrawing funds from the banks. Calling in loans during a depressionary collapse is the process by which a banking crisis explodes. Hugh Brown, a leading bank analyst with the Toronto investment dealer Burns Fry stated July 6 that the banks "have less ability now to survive a depression than they did in 1933."

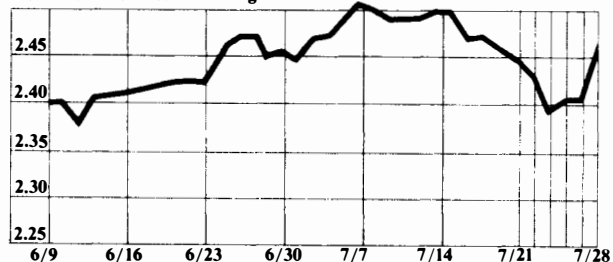
Many Canadian bank analysts are reporting that Canadian banks will have to report \$1.5 billion in bad-loan losses this year. And, according to the Toronto-based McCarthy Securities firm, another \$5.3 billion of loans do not currently pay interest. These loans become defaults if the recession deepens. The Canadian banks also have a very large exposure to Third World debt—perhaps a third of the Big Five bank loans are international loans.

*Bank Credit Analyst's* Richard Coughlin reported July 23 that the Canadian government might try to save CIBC by nationalizing the bank. However, even were that to happen, "there would be tremendous repercussions for the international banking system," he said. Canada might default on a portion of the \$25 to \$50 billion in loans that it owes U.S. banks on the interbank market.

## Currency Rates

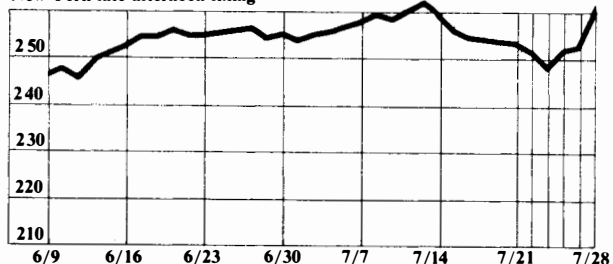
### The dollar in deutschemarks

New York late afternoon fixing



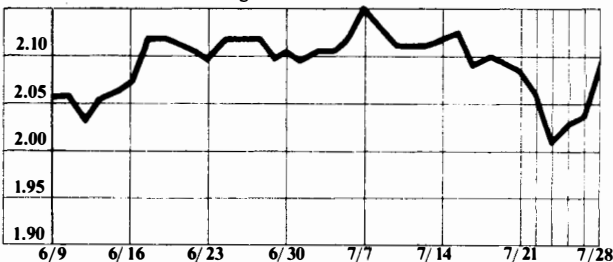
### The dollar in yen

New York late afternoon fixing



### The dollar in Swiss francs

New York late afternoon fixing



### The British pound in dollars

New York late afternoon fixing

