



Evolution of financial system risks in Canada

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The Bank of Canada treated us to its latest *Financial System Review (FSR)* today. Our related *Snapshot* offers a summary of this fresh report and accompanying commentary from key BoC officials. This one-off *Infographic* is provided for reference purposes and aims to highlight the evolution of key/noted financial system risks over the years (since the GFC).

It's perhaps of little surprise that elevated household indebtedness and frothy house prices topped the list of risks. The two are obviously intertwined. As our Table aims to highlight, the BoC has been worrying over household balance sheets and exuberant housing market conditions for a dog's age. Indeed, aside for their temporary displacement at the peak of the COVID panic, household debt and housing have been 1-2 on the financial system risk list since 2014.

If anything, the BoC is flagging that risks related to household indebtedness and housing prices have increased. Simply put, there's a lot of risk here, and there's a clear acknowledgement that monetary tightening could exacerbate financial stress. Notwithstanding this risk(y) profile, the inflation backdrop clearly leaves the BoC on the defensive, needing to jack the policy rate into more neutral territory in a hurry. That likely means getting to the top of the perceived 2-3% neutral range before year end, an adjustment that could be spurred by a potential 75 bp hike in July assuming (a) labour markets continue to look healthy (data on June 10th) and (b) core inflation continues to boil over (data on June 22nd).

Table: The more things change, the more they stay the same, with household debt/housing still very much top of mind at BoC
Key financial system risks identified in each issue of BoC's FSR (with household balance sheet & housing-related risks highlighted)

Vulnerability	Jun-22	May-21	May-20	May-19	Jun-18
1	Elevated level of household indebtedness	Elevated level of household indebtedness	Global economic uncertainty	Elevated level of household indebtedness	Elevated level of household indebtedness
2	Elevated house prices	Imbalances in the housing market	Impaired market liquidity	Imbalances in the housing market	Imbalances in the housing market
3	Reliance of some businesses on high-yield debt markets	Fragile corporate debt funding from certain markets	Loss in income & asset value	Cyber threats and financial interconnections	Cyber threats, operational risks and financial interconnections
4	High potential demand for market liquidity relative to supply	High potential demand for market liquidity relative to supply capacity	Downgrading credit & default risk	Fragile corporate debt funding from certain markets	
5	Cyber threats in an interconnected financial system	Cyber threats	<i>Note: A very special case, as FSR arrived after onset of pandemic. Concerns over HH indebtedness/housing temporarily displaced by global economic/financial market worries. But HH debt & housing moved back at the top of the list by May 2021.</i>	Climate change	
6	Mispricing of assets exposed to climate-related risks	Mispricing of assets exposed to climate-related risks		Rapid change in crypto-asset markets	
Other	Rapid evolution of cryptoasset markets	Rapid evolution of cryptoasset markets			

Vulnerability	Nov-17	Jun-17	Dec-16	Jun-16	Dec-15
1	Elevated level of household indebtedness	Elevated level of household indebtedness	Elevated level of household indebtedness	Elevated level of household indebtedness	Elevated level of household indebtedness
2	Imbalances in the housing market	Imbalances in the housing market	Imbalances in the housing market	Imbalances in the housing market	Imbalances in the housing market
3	Cyber threats and financial interconnections	Fragile fixed-income market liquidity	Fragile fixed-income market liquidity	Fragile fixed-income market liquidity	Uncertain market liquidity in fixed-income markets
4	Other: brokered deposits, increased risk-taking, corporate indebtedness	Cyber threats and financial interconnections			

Vulnerability	Jun-15	Dec-14	Jun-14	Dec-13	Jun-13
1	Elevated level of household indebtedness	Elevated level of household indebtedness	Imbalances in the housing market	Weaknesses in Euro-Area banks and sovereigns	Euro-Area crisis
2	Imbalances in the housing market	Imbalances in the housing market	Elevated level of household indebtedness	Imbalances in Canadian household finances and the housing market	Deficient global demand
3	Illiquidity and investor risk taking in financial markets	Illiquidity and investor risk taking in financial markets	Significant exposures to potential external shocks	Financial behaviour in a low interest rate environment	Canadian household finances and the housing market
4				Financial vulnerabilities in emerging-market economies	Low interest rate environment in major advanced economies

Vulnerability	Dec-12	Jun-12	Dec-11	Jun-11	Dec-10
1	Euro-Area crisis	Euro-Area sovereign debt	Global sovereign debt	Global sovereign debt	Global sovereign debt
2	Deficient global demand	Economic weakness in other advanced economies	Economic downturn in advanced economies	Global imbalances	Financial fragility associated with the weak global economic recovery
3	Canadian household finances and the housing market	Canadian household finances and the housing market	Global imbalances	Protracted recovery in advanced economies	Global imbalances
4	Low interest rate environment in major advanced economies	Global imbalances	Low interest rate environment in major advanced economies	Low interest rate environment in major advanced economies	Low interest rate environment in major advanced economies
5		Low interest rate environment in major advanced economies	Canadian household finances	Canadian household finances	Canadian household finances

Vulnerability	Jun-10	Dec-09	Jun-09	Dec-08	Note
1	Funding and liquidity	Funding and liquidity	Funding and liquidity	Funding and liquidity	<i>The Bank of Canada's Financial System Review is a long-standing publication. This infographic has focused on post-GFC issues & you'll see risks tended to focus on disorderly resolutions of global imbalances & significant corrections in the price of riskier assets.</i>
2	Capital adequacy	Capital adequacy	Capital adequacy	Capital adequacy	
3	Household balance sheets	Household balance sheets	Household balance sheets	Household balance sheets	
4	Global imbalances and currency volatility	Global economic outlook	Global economic downturn	Global economic downturn	
5	Global economic outlook	Global imbalances and currency volatility	Global imbalances and currency volatility	Global imbalances and currency volatility	

Source: NBF, BoC | Note: The above table reflects the key risks outlined in each FSR; we have highlighted risks specific to household balance sheets & housing markets

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