

A TALE OF TWO CRISES

As the United States finds itself mired in a financial crisis, many observers point to the experience of Japan during the 1990's as a blueprint for the future. This week's Marker reviews the parallels and differences between two financial crises that rocked the world's two largest economies less than 20 years apart.

A COSTLY CRISIS

The International Monetary Fund has released an estimate of the dollar cost of the current credit crisis. If its estimates prove to be correct, losses could reach \$1,000 billion. This crisis would be the most expensive - in dollar units - in history, though it would not be nearly half as bad as Japan's nightmarish economic descent measured relative to GDP, as substantiated by the table below.

FINANCIAL PAIN: THE NEW EXPORT?

The differences between the current crisis and Japan's earlier edition do not stop at size relative to GDP. One key feature of the present occurrence is that over 70% of losses will be absorbed by investors, many of which, as evidenced by write-offs taken by large European banks, are located outside of the U.S. It does indeed appear that the excesses of sub-prime lenders will be felt around the world in the form of financial losses. From the debt of emerging countries of the former eastern European block, unable to benefit from the global boom in commodity prices, to housing in the Hampton's, asset values are reacting negatively to tighter credit.

COMPARING APPLES AND ORANGES

The broad dispersion of losses from the current credit crisis is only but one important difference between the U.S. and the Japanese experiences. No less a respected expert on the issue than Richard Fisher, president of the Federal Reserve Bank of Dallas, made clear recently that the circumstances in each country are similar in one single regard: large drops in asset values. Japan's economy and society were, and still are, characterized by extensive government intervention and inflexible rules while the U.S. is all about private market solutions and very flexible markets. Additionally, the vast majority of losses in Japan's real estate bust had to be absorbed by domestic banks while the current situation will see much greater dispersion. Furthermore, the critical process of recognizing losses is proceeding much faster in the U.S. than in Japan, which went through at least four years of deep denial before beginning to openly discuss the need to reorganize its banking system. Broader sharing of losses is both a blessing and a cause for greater systemic risk; yet, it should facilitate the overall adjustment process. We quote Mr. Fisher: "We are adjusting much more quickly. We are going through the price discovery process. It is enormously painful but it is happening".

Estimates of Financial Sector Potential Losses
(in billions of USD, March 2008)

	Estimates of Losses on Unsecuritized U.S. Loans	
	Outstanding	Estimated Loss
Subprime	300	45
Alt-A	600	30
Prime	3,800	40
Commercial real estate	2,400	30
Consumer loans	1,400	20
Corporate loans	3,700	50
Leveraged loans	170	10
Total for loans	12,370	225

Estimates of Mark-to-Market Losses on Related Securities

	Outstanding	Estimated mark-to-market loss
ABS	1,100	210
ABS CDOs	400	240
Prime MBS	3,800	0
CMBS	940	210
Consumer ABS	650	0
High-Grade Corporate Debt	3,000	0
High-Yield Corporate Debt	600	30
CLOs	350	30
Total for securities	10,840	720
Total for loans and securities	23,210	945

Sources: Goldman Sachs; JPMorgan Chase & Co.; Lehman Brothers; Markit.com; Merrill Lynch, and IMF staff estimates

NATCAN WEEKLY MARKER

Observers are quick to point to the apparent similarities between the crisis currently engulfing the U.S. and that which took place in Japan almost 20 years ago. A deeper examination of the facts illustrates how different the situations are, calling into the question the risk of assuming the U.S. is headed for a long period of economic stagnation. Financial excess always gets cleared through a country's banking system. This time is no different and while there certainly is more pain to be experienced, investors should also take solace in the fact that financial players and regulators are implementing the necessary measures to right the ship. Realism and cool minds will be rewarded in the coming months at the likely expense of extreme pessimism.

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FINANCIAL MARKETS

RETURNS AS AT APRIL 11, 2008 (%)	MTD	QTD	YTD
S&P/TSX	2.55	2.55	-0.37
S&P 500	0.54	0.54	-5.97
S&P/TSX Small Cap	1.55	1.55	-2.56
Russell 2000	-0.23	-0.23	-7.16
MSCI EAFE	1.97	1.97	-3.43
MSCI World	1.31	1.31	-4.22
DEX Universe Bond	-0.73	-0.73	2.21

	RATES AS AT APRIL 11, 2008
CAD/USD	1.02
CAD/Euro	1.62
US Treasuries yield 10-yr/30-yr	3.47/4.30
GOC bond yield 10-yr/30-yr	3.55/4.06
Fed Fund Rate (target)	2.25

Note: Returns in Canadian dollars, London 4h exchange rates. Source: Datastream, PC Bond, MSCI-Barra, and Bloomberg. PC-Bond, a business unit of TSX Inc. Copyright © TSX Inc. All rights reserved.

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