Banks' efforts to ease Europe's debt crisis may benefit B.C.

Move frees up cash and makes bonds more attractive to foreign investors

BY TRACY SHERLOCK, VANCOUVER SUN DECEMBER 1, 2011

If a lot of people choose to invest in Canada and its provinces, the yield on Canadian bonds would go down.
Photograph by: BRENDAN MCDERMID, REUTERS

VANCOUVER - Europe's debt crisis led top central banks around the world — including Canada's — to join together to free up funds Wednesday and ease the strain on financial markets. Meanwhile, the crisis has raised the profile of government bonds, with Italy's bonds giving yields of seven per cent or higher.

The move by the central banks to lower the cost of borrowing U.S. dollars and increase liquidity came as the People's Bank of China cut reserve requirements, which will allow Chinese banks to lend more money.

Canada and British Columbia may benefit from both of these moves, financial experts told The Sun on Wednesday.

“This frees up a lot of cash for them to loan it out for industrial or commercial projects. It’s a good thing if you’re a buyer of Canadian resource equities because the largest consumer on the planet now of resources is China,” said investment adviser Bob Haber, a portfolio manager for Canoe Financial and former chief investment officer for Fidelity Canada.

The fact the central banks are working together shows they understand the severity of the global economic crisis, Haber said. “It doesn’t solve all of the world’s problems in one fell swoop, but what it does show is that the central banks understand the severity of the problem and now are acting in unison — and I would argue, also acting with China — to keep the problem from getting worse and perhaps rekindle growth through looser monetary conditions,” he said.

The high-risk perception of European bonds could benefit B.C. because it makes our bonds more attractive, and therefore gives the provincial government access to cheaper borrowing for many years to come, said Jamie Price, director of fixed income at Macquarie Private Wealth.

Bonds are government loans to the public that promise a specific rate of interest and a specific payback date. There are two elements to a bond’s yield: the interest rate and the selling price. The interest rate is determined first, when bonds sell at par at a government auction, Price said. If demand is low, the government will increase the interest rate to attract more buyers, Price said.

Bonds then trade on the secondary market, where the purchase price is determined by supply and demand, Price said. If the price goes down, the yield automatically goes up.

“Price and yield always move in opposite directions and one is inextricably linked to the other,” Price said. “The only way that doesn’t happen is if the bond defaults — they stop paying the interest and the bond doesn’t mature.”

Government defaults are a real risk. For example, Argentina defaulted in 2001, Price said.

A person’s risk tolerance will determine whether high-yield bonds are a worthwhile investment opportunity, Price said.

“If the primary objective is to not lose any money, then we explain to them that they’re going to have to put up with very low returns to protect their money,” Price said. “So, lending to the government of Canada, for example, is going to return you in the very low single digits — between zero and two per cent — but you’re almost guaranteed that Canada is going to pay you back.”

If a lot of people choose to invest in Canada or its provinces instead of in Europe, the yield on Canadian bonds already in the market would go down. This is a benefit for Canada, or B.C., because if new bonds are issued, it would be at a lower interest rate.

“That means that B.C. will lock in for the next 10 years at a lower interest rate — that’s definitely a

benefit because it means that they can borrow for cheaper," Price said.

Meanwhile, Wednesday's announcement may be a signal that China would like to return to growth, Haber said. Out of concern for rising inflation earlier this summer, the Chinese central bank raised their reserve requirements, which meant banks had less money to lend.

tsherlock@vancouversun.com

Blog: vancouversun.com/yourmoney

© Copyright (c) The Vancouver Sun