

Canada's source for market intelligence

Foreign investors help keep Canadian mortgage rates low

[John Shmuel](#) Sep 12, 2011 – 4:45 PM ET | **Last Updated: Sep 13, 2011 12:49 AM ET**



Jason Lee/Reuters

Residential and commercial buildings are pictured in Vancouver, British Columbia June 20, 2011.

Enjoying low mortgage rates? You can give a big thanks to foreign investors.

Foreign investors snatched up \$8.5-billion worth of Canadian bonds in the second quarter, bringing the total of bonds bought by foreigners in the past year to \$25-billion, data from Statistics Canada Monday showed. Foreign investors now hold a record \$137-billion worth of Canadian bonds.

But it is not just the Government of Canada benefiting from the stream of investors willing to lend it money. All those bond purchases are driving down yields, and consequently, lending rates in Canada.

“This increased foreign interest in the Canadian market is having important macroeconomic consequences, by lowering borrowing costs for households,” Sheryl King, economist with Bank of America Merrill Lynch, said in a note.

Figures suggest that external purchasing of the country’s debt will continue. Foreigners have reduced their Canadian bond holdings only twice since December 2008, following that year’s financial crisis.

While Ms. King notes that there are upsides and downsides to all that foreign money buying up Canada’s debt, in the near-term, it’s definitely an economic plus for the country.

“Debt service costs of interest and principle remain well within affordable levels,” she said.

That’s because all those foreign bond purchases are putting downward pressure on bond yields. Estimates from Bank of America Merrill Lynch show that foreign purchases have reduced yields on Canadian 10-year bonds by roughly 100 basis points in the past three years — and 30 bps in the first half of 2011 alone.

As a result, foreign purchases have flattened the curve between the 10-year and 2-year notes by nearly 60 bps during the past three years. The yield on the 10-year Government of Canada bond rose slightly to 2.13% on Monday, continuing to hover near a record low. Yields are down substantially after hitting a near-term high of 3.5% in April.

While Ms. King highlighted that Canadians are enjoying the lower interest rate environment, all that free-flowing credit could cause a problem down the road. Canada’s households are already amongst the most indebted in the world. The average Canadian debt-to-income level sits at a staggering 147% — even higher than households in the United States.

“The rising household debt burden may be a longer-term drag on the economy should rates rise from these levels in the years to come,” Ms. King said.

Douglas Porter, deputy chief economist at BMO Capital Markets, points out that as a share of GDP, the country’s net debt position has now widened to 12.8% from as low as 2.3% in early 2009.

“While the net debt is still a fraction of the levels in the early 1990s, when foreign debt pushed above 40% of GDP, the trend bears watching,” he said in a note.

While Monday’s data shows foreigners scooped up Canadian assets in the second quarter, risk aversion has reared its head in recent weeks. The Canadian dollar fell below parity briefly against the U.S. dollar Monday, dropping to its weakest level in more than seven months against

the greenback. Fears over a possible Greek default in the coming months have driven investors away from risk in the past week.

The loonie finished the day up 0.00010¢, or 0.010%, against the U.S. dollar, closing at US\$1.0029.

But while the Canadian dollar has lost ground against its American counterpart, it was still performing relatively well when compared with other resource-linked currencies such as the Australian and New Zealand dollars. The Australian dollar lost 1.7% against the U.S. dollar on Monday, while the New Zealand dollar dipped 0.5%.

Posted in: [Investing](#), [Real Estate](#) Tags: [BMO Capital Markets Corp.](#), [Canadian Economy](#), [John Shmuel](#), [Merrill Lynch & Co. Inc.](#), [Sheryl King](#), [Statistics Canada](#), [U.S. dollar](#)