

Globeinvestor**GOLD**

Not all are losers in debt crisis

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The sovereign debt crisis in Europe has many investors very nervous, but it's not all bad news for those on the right side of the moves in bonds and the dollar. Home buyers and travellers to Europe are benefiting. Insurers and exporters are among the potential losers.



MORTGAGE RATES

Financial instability in Europe has caused investors to flee to the safety of U.S. and Canadian government bonds. Demand for five-year Government of Canada bonds has pushed their yields lower in recent weeks. The lower yield reduces the borrowing cost for banks, making it cheaper for them to fund their five-year fixed-rate mortgages. With financing costs falling, Toronto-Dominion Bank took the lead last week and cut its mortgage rates. In the days since, most banks have followed suit, decreasing their rates by between 10 and 15 basis points.

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INTEREST RATES

Bank of Canada Governor Mark Carney has said sovereign debt poses the biggest risk to the global recovery. A worsening crisis in Europe could delay his first post-recession interest-rate hike, even though the Canadian economy has rebounded more sharply than expected and recouped about two-thirds of the jobs lost during the downturn. Just as the U.S. financial crisis in 2008 forced Mr. Carney and policy makers around the world to slash borrowing costs to record-low levels, the made-in-Europe mess may again force him to act more globally than locally. Last month, Mr. Carney signalled he might start raising rates as soon as June 1, saying the need for “extraordinary” stimulus was passing. On the weekend though, the Bank of Canada took on a bit part in an effort by major central banks to help prop up investor confidence in Europe through the not-so-ordinary step of re-opening currency swap lines to counter signs that lenders were hoarding U.S. dollars.



INSURERS

Canadian life insurers have been eagerly anticipating the earnings lift that could come with higher interest rates, but the situation in Europe threatens to delay that. In many instances, Canadian Generally Accepted Accounting Principles require insurers to use current interest rates to value items on their books. “It forces us to confront the reality that if rates stayed low, this would be the outcome, so we take a hit for that,” explained Manulife Financial Corp. CEO Don Guloien. “As interest rates return to more normal levels, you would expect that to show up in profitability.”



CURRENCY

One of the swiftest and most direct ways the European crisis is affecting Canada is through currency markets. The Canadian dollar has surged 17 per cent against the euro this year, hitting an eight-year high Tuesday. And it has climbed 12 per cent against the British pound.

The ripple effects are numerous. It's making travel to Europe much cheaper this summer, and conversely, turning Canada into a much costlier place for European visitors.

It also affects business – Canadian exporters are having a tougher time competing in Europe because their goods have become pricier. On the flip side, imports from Europe have become cheaper. And cheaper imports, in turn, could eventually lead to a softer inflation rate.

It's not just the appreciation – wild swings and volatility in foreign-exchange markets in recent weeks has wreaked havoc with business planning.



TRADE

A slump in Europe could affect trade. The European Union, including the U.K., accounts for 8 per cent of Canadian exports, and 12 per cent of Canadian imports, making the region a key trading partner. (The U.K. is Canada's No. 2 export destination after the United States.) If Europe's woes persist, demand in the region could drop. That has a direct impact on many Canadian exporters, but could also weigh on commodity prices.

The best way for Canada to help Europe through its tribulations would be to seal a free trade agreement, said Werner Antweiler, trade specialist at the University of British Columbia. "If Canada wants to strengthen economic ties with the EU, and help Greece along the way, putting more serious effort into forging ahead with a free trade deal with the EU would be good for both sides."

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