Five-Year Yields Hit Highest Since October 2008: Canada Credit

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By Chris Fournier

April 6 (Bloomberg) -- Canada's five-year bond yields rose to the highest level since October 2008 as banks hedged mortgages and the nation's fixed-income market caught up to declines in U.S. Treasuries.

Canada's home buyers are stepping up borrowing as they seek to beat pending changes to mortgage regulations and increases in interest rates. Banks that issue mortgages protect their balance sheet by selling similar-maturity securities in the secondary bond market or by making swap transactions.

"Banks are hedging seasonal mortgage flows, which is weighing on the five-year sector," said Mohammed Ahmed, a rates strategist at Canadian Imperial Bank of Commerce in Toronto. "Banks are receiving a fixed-rate asset and to hedge that, they typically pay the fixed-rate in swaps, or sell cash bonds."

Canada's benchmark five-year bond yielded 3.04 percent yesterday, 15 basis points higher than the 2.893 percent close on April 1. The price of the 2.5 percent security maturing in June 2015 fell 64 cents to C$97.52. Canadian fixed-income markets were closed on April 2 for the Good Friday holiday. The markets were open in the U.S.

U.S. Treasury 10-year notes rose above 4 percent yesterday for the first time since June. The yield, which moves inversely to prices, climbed eight basis points on April 2 after the Labor Department reported U.S. companies added 162,000 workers in March. It climbed another six basis points yesterday as reports on the service industries and pending home sales added to signs the U.S. economic recovery is gaining traction.

‘Catch-up’

“Five-year yields have had some ‘catch-up’ from firmer details in Friday’s U.S. employment report, stronger than expected releases in the U.S., and some domestic pressures as well, which may be related to fixed-mortgage demand,” said Mark Chandler, a fixed-income strategist in Toronto at Royal Bank of Canada, the nation’s largest lender.

Elsewhere in credit markets, Canada’s Finance Minister Jim Flaherty will speak to reporters at 5:30 p.m. New York time today in Charlottetown, Prince Edward Island, before holding a town hall meeting on pension reform.

The bank of Canada tomorrow will auction C$3 billion ($3 billion) of 1.5 percent bonds maturing June 2012. The previous auction of two-year bonds on March 10 drew an average yield of 1.725 percent and a bid-to-coverage ratio 2.92 times, according to data on the central bank’s Web site.

Canada’s five-year swap rate -- a measure of the expectation for 3-month interest rates over five years -- rose 17 basis points yesterday to 3.175 percent, the highest level since October 2008.

Mortgage Rule Changes

The extra yield investors demand to own Canadian corporate bonds instead of comparable government debt was unchanged yesterday at 117 basis points. A basis point is 0.01 percentage point.

Flaherty tightened rules in the country’s mortgage market Feb. 16 to ensure buyers can afford their homes when interest rates rise. Under the changes for mortgages eligible for government insurance, which take effect April 19, buyers will have to meet standards for five-year, fixed-rate mortgages even if they opt for variable rates. Limits on refinancing will be stricter and people buying a home that they don’t occupy must make a down payment of 20 percent.

Royal Bank of Canada lifted its five-year fixed-mortgage rate by 0.6 percent to 5.85 percent, according to a March 29 statement. Toronto-Dominion Bank and Laurentian Bank also raised mortgage rates.

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