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Carney Focus on Dollar Over Growth Cuts Yields: Canada Credit
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Jan. 19 (Bloomberg) -- Bank of Canada Governor Mark Carney is likely to stress today a strong currency is curbing exports, suggesting domestic and U.S. economic recoveries won't prompt a quick interest-rate increase, possibly lowering bond yields.

The central bank kept its key interest rate at 1 percent yesterday and reiterated that further boosts would be "carefully considered." Policy makers also raised their growth forecast, adding the economy won't return to full output until the end of 2012 because the currency -- which hit a 31-month high against the U.S. dollar -- is "restraining" sales abroad.

Carney led the Group of Seven nations by raising interest rates three times last year, starting in June. Canada's currency has appreciated 6.4 percent against the U.S. dollar since then, pressuring exporters.

"While the currency is doing a lot of tightening for the bank, it is very difficult for the bank to add tightening on top of that," Edward Devlin, a money manager at Pacific Investment Management Co. in Newport Beach, California, said in an interview yesterday with Business News Network. "We see a lot of demand for the Canadian dollar from global institutions, and we think that will continue."

The yield on the March bankers' acceptances contract, a barometer of short-term rate expectations, fell to 1.38 percent yesterday from 1.425 percent Jan. 17. Bax contracts, a barometer of short-term interest rate expectations, have settled an average of 18 basis points above the central bank's rate since 1992, Bloomberg data show.

## Bond Sales

Elsewhere in credit markets, Bank of Montreal issued U.S. dollar-denominated covered bonds, RioCan Real Estate Investment Trust sold C$225 million ($227 million) of bonds and Financement Quebec offered C$600 million of its bonds due in December 2017.

Bank of Montreal sold $1.5 billion of covered bonds, according to data compiled by Bloomberg. The five-year securities pay 69.7 basis points more than similar-maturity U.S. Treasuries, Bloomberg data show. The bank issued $2 billion of covered bonds on June 2. The 2.85 percent notes, due in 2015, were priced to yield 72.3 basis points more than Treasuries.

The extra yield investors demand to own the debt of Canadian investment-grade corporations rather than the federal government remained at 133 basis points yesterday, or 1.33 percentage points, according to a Bank of America Merrill Lynch index. Yields rose to 4.01 percent, from 4 percent on Jan 17.

Canadian corporate bonds have lost 0.5 percent since the start of the year, compared with a loss of 0.9 percent for Canadian government bonds, according to Bank of America Merrill Lynch data.

## Provincial Spreads

In the provincial bond market, relative yields narrowed to 54 basis points yesterday from 55 on Jan. 17. Yields were unchanged at 3.42 percent. The securities have lost 1.3 percent this month.

Standard & Poor’s raised its debt rating outlook on Saskatchewan to positive from stable, saying it expects the province’s operating results to improve as the economy expands while debt remains “low and stable.” S&P also affirmed its ‘AA+’ long-term issuer rating on the province.

Financement Quebec, which seeks loans on behalf of schools, universities and hospitals in Canada’s second-most populous province, sold C$600 million of bonds due in December 2017. The 3.5 percent notes were priced to yield 71 basis points over comparable government bonds.

RioCan Real Estate Investment Trust sold C$225 million of unsecured notes. The 4.5 percent bonds, which mature in January 2016, were priced to yield 192.5 basis points over comparable government securities.

## First Capital

Citing investor demand, First Capital Realty Inc. boosted the size of its senior unsecured debenture sale by 20 percent to C$150 million, citing investor demand. The 5.48 percent bonds, which mature in July 2019, were priced to yield 231.5 basis points over comparable government securities.

Foreign purchases of Canadian securities were headed for a second straight annual record late last year, led by bonds. The January-to-November total net purchase of C$106.7 billion exceeded the C$99.5 billion recorded in the same period of 2009, Statistics Canada said Jan. 17. Foreign purchases were a record C$110.9 billion in 2009.

Bill Gross, manager of the world’s largest bond fund at Pimco, said in a Dec. 22 interview investors should avoid U.S. dollar-denominated government debt weighed down by budget deficits and invest in bonds in Canada, Mexico and Brazil.
Higher Canadian interest rates could also boost the dollar by giving another reason to buy the country’s bonds.

## Growth Outlook

The Bank of Canada said yesterday that gross domestic product will grow 2.4 percent this year and 2.8 percent in 2012, compared with an October forecast for gains of 2.3 percent and 2.6 percent, respectively. The central bank said U.S. growth is being boosted by the extension of tax cuts and the Federal Reserve’s plan to buy $600 billion of Treasury securities through June.

“Net exports are projected to contribute more to growth going forward, supported by stronger U.S. activity and global demand for commodities,” the bank said in its statement.
“However, the cumulative effects of the persistent strength in the Canadian dollar and Canada’s poor relative productivity performance are restraining this recovery in net exports.”

The Canadian currency weakened 0.4 percent yesterday to 99.13 cents per U.S. dollar after earlier gaining to 98.38 cents, the strongest level since May 2008. It was the best performer over the past three months in a measure of 10 developed-nation currencies, appreciating 3.27 percent.

Canada’s trade surplus with the U.S., its largest trade partner, was the lowest in September since December 1993 at C$1.55 billion. Canada sends about three-quarters of its exports to the U.S., including factory products such as automobiles and machinery.

“That’s a big issue for the Bank of Canada, they won’t want the dollar to run away,” said Krishen Rangasamy, an economist at CIBC World Markets in Toronto, who predicts a May rate increase.

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