Banks begin to decline federal aid in first sign of recovery

Credit conditions easing, banks no longer struggling to raise funds to make loans

Tara Perkins
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Canadian banks are turning down some of the funding that the government is making available to them, a sign that they are recuperating from the financial crisis.

The banks have stopped selling the government the full amount of mortgages they could under Ottawa's $125-billion mortgage purchase program, the centrepiece of the federal government's plan to help the industry.

“We actually don't need a lot of funding right now,” a senior banker at one of the big five banks said yesterday. “All of the Canadian banks are pretty flush right now with cash.”

That's not to suggest they aren't facing problems, with consumers increasingly losing their jobs and unable to pay off their debts. But the banks are no longer struggling to raise funds to make loans – at least for now.

Credit conditions for Canadian banks have improved since late last year, as Canadians jittery about the stock market have left more of their money in bank accounts, giving them a ready pot of cash to fuel lending. At the same time, global credit markets have eased slightly as central banks have pumped billions of dollars into the financial system.

Federal Finance Minister Jim Flaherty announced the creation of the mortgage purchase program in early October, when it was extremely difficult for banks around the world to fund their lending operations.

He originally said Ottawa would buy up to $25-billion of mortgages from the banks, through Canada Mortgage and Housing Corp., to free up capacity for them to make new loans.

The purchases take place in periodic auctions that actually turn a profit for the government. Ottawa tells the industry how much it is willing to buy – for instance, $5-billion worth of mortgages held by the banks on their balance sheets – and then the banks each say how much they would be willing to pay, in the form of interest, to sell mortgages to the government. CMHC accepts the most profitable bids.

Bankers have been griping that the program, which is projected to earn billions of dollars for Ottawa, is expensive. But until last month, that hadn't stopped them from selling all of the mortgages that they could into it, and pressing Mr. Flaherty to buy even more. Well into the new year, banks continued to have trouble raising medium-term funds.

Ottawa boosted the size of the program twice, most recently announcing in the federal budget that it would buy a total of up to $125-billion worth of mortgages. The program has been successful in leading to a reduction in mortgage rates for Canadians, with banks passing on their lower funding costs.

But in the last couple of auctions, the banks have not sold the full amount of mortgages Ottawa was willing to buy. The most recent one took place on March 11, when CMHC told the banks it would buy up to $4-billion worth. Banks sold it about half that, $2.1-billion.

That followed the Feb. 20 auction, when banks sold CMHC $2.3-billion worth after it said it would buy up to $7-billion from them.

There are a couple of reasons why the banks have lost some of their appetite for the government aid.

More Canadians are pulling their cash out of mutual funds and riskier investments and parking it in deposits, such as chequing accounts and GICs. Deposits are the largest source of funding for the banks. If stock markets recover, and customers shift their money back into mutual funds and equity investments, the banks could find themselves in need of funding help again, notes Toronto-Dominion Bank chief economist Don Drummond.

At the same time, the growth of banks' loan portfolios is slowing. The soft housing market led to very weak mortgage originations in January and February, Mr. Drummond said.

Still, the slackening demand for government help does suggest that credit conditions have eased. The lack of take-up on the mortgage auctions “seems to point to the fact that the Canadian banks are not in a big liquidity crunch themselves,” said Marlene Puffer, a managing director at Twist Financial Corp.

That means the banks' lending operations are not being held back by an inability to raise financing, she added: “Any constraints in terms of the banks lending are coming more from inside the banks than any constraints they're facing in terms of raising capital.”

The Canadian Bankers Association said in an e-mailed statement that the mortgage purchase program is still an effective tool, noting that it's already injected more than $53-billion worth of liquidity into the marketplace so far.

A spokeswoman for CMHC declined to comment yesterday, noting that the details of the auctions are confidential.