The Oil Drum: Canada
DISCUSSIONS ABOUT ENERGY AND OUR FUTURE

The Round-Up: July 13th 2007

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In the fields of finance and energy, there have been some remarkable developments this week, particularly with institutions that reverse their stated views, and probably their tactics and policies.

The IEA earlier released a report that said, though not in so many words, that peak oil is near. Then its CEO Claude Mandil gave an interview to Le Monde, in which he said Russia has peaked, and OPEC is not telling the truth about world oil supplies.

S&P and Moody's, Wall Street's preferred rating agencies, changed their approach to the ongoing mortgage malaise by downgrading, or threatening to downgrade, many mortgage-based investment grade bonds. This shift will be felt throughout the credit markets, and there may be much more to come. And the UK is now joining the mortgage mayhem crowd.

No such shift for NAR: they predict US home prices will rebound in 2008, though foreclosures rose 87% and a record number of ARM's will reset this fall.

Meanwhile in Canada, the sovereignty that our government seeks to defend in the Arctic is being undermined at an SPP meeting in Montebello, Quebec.

Canada flexes its muscles in scramble for the Arctic

> Mr Harper's message, and the belligerent style in which it was delivered, are a sign that the Arctic, the vast ice-covered ocean around the North Pole, is hotting up - both literally, through global warming, and metaphorically as a political issue. With Canada, Denmark, Russia and the United States all having claims on the region, together with those of Iceland, Norway, Sweden and Finland, international tension in the region is mounting.
>
> There was no dissembling in Mr Harper's speech. "The ongoing discovery of the north's resource riches, coupled with the potential impact of climate change, has made the region a growing area of interest and concern," he said. As the statement implies, two areas of international competition lie behind the Canadian prime minister's actions. The first is that the Arctic region is rich in natural resources. It is thought to hold up to a quarter of the world's undiscovered reserves of oil and gas, which as the established fields in the Middle East and elsewhere run dry will become increasingly valuable and sought after. There are also known to be major deposits of diamonds, silver, copper, zinc and, potentially, uranium. It also has rich fish stocks.
>
> Desire to exploit these resources has led to tensions with the US over the offshore border between Alaska and Canada, an area known as the "wedge", where one day oil

and gas exploration could prove to be lucrative.

Canada Ups Military in Disputed Arctic

> Canada announced plans Monday to increase its Arctic military presence in an effort to assert sovereignty over the Northwest Passage -- a potentially oil-rich region the United States says is international territory.
>
> Prime Minister Stephen Harper said six to eight patrol ships will guard what he says are Canadian waters. A deep water port will also be built in a region the U.S. Geological Survey estimates has as much as 25 percent of the world's undiscovered oil and gas.
>
> U.S. Ambassador David Wilkins has criticized Harper's promise to defend the Arctic, claiming the Northwest Passage as "neutral waters."

Arctic study has high costs, but will clarify climate change picture: scientist

> Starting in two weeks, teams of scientists will begin setting off on expeditions aboard the Amundsen, a Canadian Coast Guard icebreaker that has been turned into a floating laboratory.
>
> Their research over the next 15 months comes with a hefty price tag - it will cost an estimated $40,000 a day just to operate the Amundsen. At Wednesday's official launch, Treasury Board president Vic Toews announced the federal government will kick in $25.5 million.
>
> The work is useful for science as well as sovereignty, Toews said.

Public forums denied on upcoming SPP Summit

> The Council of Canadians, after renting a public facility in the Municipality of Papineauville (about 4 miles from Montebello), were bluntly informed by the hall's management that the RCMP (Royal Canadian Mounted Police), SQ (Security Quebec) and the U.S. Army will not allow their meeting even though it is scheduled on the day before the SPP meeting!
>
> In fact, these security officials allegedly declared that they intend to enforce a 25 kilometer (about 15 miles) blackout around the Chateau Montebello where Bush, Harper and Calderon will be meeting to advance their agenda of "deep integration" of Mexico, Canada and the United States.
>
> “It is deplorable that we are being prevented from bringing together a panel of writers, academics and parliamentarians to share their concerns about the Security and Prosperity Partnership with Canadians,” said Brent Patterson, director of organizing with the Council of Canadians. “Meanwhile, six kilometers away, corporate leaders from the United States, Mexico and Canada will have unimpeded access to our political leaders.”

[Erosion of Alaska's north coast speeding up]

> The speed of coastal erosion on Alaska's far northern coast has doubled over the past 50 years and coastal cliffs saturated with melting permafrost have crumbled into the sea as the world's climate has warmed, scientists report.
>
> Using evidence from satellite observations and aerial photographs, two geologists at the U.S. Geological Survey have concluded that pack ice shrinking rapidly over the Beaufort Sea has probably caused the waves to surge more powerfully against the weakened cliffs.
>
> At the same time small inland lakes have expanded as ice covering their surface has melted away, the scientists say. In some instances the land-locked margins of ice-covered lakes that were isolated from the coast 50 years ago have moved north until erosion has turned them into open bays exposed to continuous flooding by ocean water, the geologists say.

[Study: Inaction on Warming Will Be Costly]

> People in Philadelphia would swelter through as many as 30 days over 100 degrees each summer. The entire Northeast ski industry except western Maine would likely go out of business. And spruce and hemlock forests -- as well as song birds such as the Baltimore oriole -- would all but disappear from New Jersey to the Canada border.
>
> These are some of the conclusions of a two-year study by the public interest group Union of Concerned Scientists of the effects of global warming in the Northeast if current greenhouse gas emission patterns around the world continue unabated. Winters will be on average 8 to 12 degrees warmer by the end of the century, and summers 6 to 14 degrees hotter.

[Record-breaking heat continues throughout B.C]

> Back in downtown Vancouver, workers had to turn down the AC and bear the sweltering 27 degrees with 50 per cent humidity as the city's power supply fell short.
>
> One of British Columbia Hydro's two downtown transformers is broken -- so officials asked businesses to conserve power at an inopportune time.
>
> With temperatures this high ... we could put an increased load on the (broken) transformer," said Gillian Robertson, a representative for BC Hydro.
>
> "We don't want to stress it out -- we don't want to cause it any sort of strain."
>
> Residents in the Lower Mainland took shelter and tried to get their hands on anything cold as the mercury rose, shattering records held for decades.

Risky Business

> Economists, scientists and politicians around the world and at home have told us that climate change can be tackled if we figure out a way to capture massive volumes of carbon dioxide and store it underground.
>
> Former U.S. vice-president and environmental crusader Al Gore says it's part of the solution. So does Tim Flannery, author of the global warming book The Weather Makers, and British economist Sir Nicholas Stern.
>
> In industry lingo the approach is called carbon capture and sequestration, or CCS, and the federal Conservative government has hyped it as a way to keep greenhouse gas emissions from the Alberta oil sands and other petroleum-industry operations at a Kyoto-friendly level.
>
> In many ways, they pitch it as a silver bullet while conveniently ignoring the potential financial and safety risks. But assuming it can work and is safe, what about taking such an approach in Ontario?

A healthy world needs lots of species

> Biodiversity loss could impact food production, water quality and carbon dioxide levels more than previously thought, scientists have discovered.
>
> Andy Hector of the University of Zurich, Switzerland, and his colleague Robert Bagchi from the University of Oxford, UK, developed a method to analyse how the number of species in a place affects its combined set of ecosystem processes such as decomposition and soil formation, nutrient and water recycling and plant growth. A 1997 estimate put the value of such ecosystem services to humanity as US$33 trillion a year.
>
> Using data for European grasslands, Hector and Bagchi discovered that as more ecological processes are taken into account, the number of species required to sustain them also increases. Most previous studies have looked at ecosystem processes in isolation.

Pollution Making Great Lakes Fish Inedible

> Describing the Great Lakes as an "international treasure," the report says the lakes are a unique storehouse of almost 4,000 species of fish, plants, and animals. Lakes Erie, Huron, Michigan, Ontario, and Superior constitute about 20 per cent of the world's fresh water.
>
> The lakes generate electricity for homes and industry across a 521,000 km basin and beyond, and support recreational activities for a large population, including anglers and aboriginal communities, along its 17,000 km coastline.
>
> But pollution from industrial, municipal, and agricultural sources poses the greatest threat, says the report, with over 92 billion tons of raw sewage emptying into the Lakes each year from Canadian and U.S. sources.

In 2002 alone, a cocktail of 627 million kilograms of chemical pollution from industry seeped into the lakes. The hazardous chemicals, including methylmercury, PCB's, Dioxins, furans, and pesticides were released into the air, water, and land of the Great Lakes basin, while five million kilograms washed directly into the water.

Oceans dying; Fresh water supply to plummet

Water experts say that over 1.2 billion people lack safe water supplies. Climate specialists anticipate that due to global warming and sea-level rise, one billion additional people will be without adequate, clean water in a few decades. This totals over two billion, but the future is murky, and the figure could be low because all the scientific consensus-warnings on climate change have been too conservative. Additionally, changes in world climate have happened much sooner than expected.

Fresh water withdrawal rates even exceed population growth. When certain trend lines cross, something on the chart takes a dive.

Perhaps the overarching problem can be termed the global culture of extraction and expansion.

Oilsands Quest Estimates Resource Potential at 10 Billion Barrels

Oilsands Quest Inc. announces management's estimate of resource potential of 10 billion barrels of bitumen for its contiguous oil sands exploration permits in northwest Saskatchewan and northeast Alberta. This estimate includes management's estimate of Original Bitumen In Place (OBIP) for the Axe Lake Discovery on its Saskatchewan permits as well as management's estimate of resource potential on certain portions of the remainder of its Saskatchewan permits and its adjacent Alberta permits.

Global warming threatens alternative-oil projects

Oil-sand, oil-shale, and coal-to-oil projects – alternative fuel sources that could enhance US energy security – have always faced one hurdle. They look good only when oil prices are high. Now, they have another challenge: global warming.

California has enacted new climate-change policies that make energy companies responsible for the carbon emissions not just of their refineries but all phases of oil production, including extraction and transportation. If that notion catches on – at least two Canadian provinces have already signed on to California's plan – then the futures of oil-sand, shale, and coal-to-oil projects may look less attractive.

The reason: Extracting these alternative sources of oil requires so much energy that their "carbon footprint" may outweigh their benefits.

IEA boss denies and confirms peak oil in same breath

It seems that the International Energy Agency, the intergovernmental energy watchdog, has been going in overdrive lately. First, we had the interview of its chief economist warning us that we were going toward a wall without Iraqi oil, then the recent publication of their yearly outlook report predicting shortages within 5 years, and now we have another disquieting interview in Le Monde, the big French daily, with Claude Mandil, the head of the Agency, who pulls no punches, despite an apparent denial of "peak oil".

Eight Reasons Everyone Should Support Light Rail

Everyone should support light rail, even people who don't necessarily plan to use it. Light rail is a true public good, a civic infrastructure that helps everyone, not just its direct beneficiaries.

Bye-bye hybrid?

Rumblings in the automotive world suggest that Honda killing its Accord hybrid may have been just the canary in the over-hyped hybrid coal mine. Honda's decision raises the question: Are hybrids just a fad -- a short-term solution to a long-term problem?

Until now, the big reason why people bought hybrids was the dual promise of frugal fuel consumption and zero emissions — save your money, save the Earth.

Trouble is, the media has generated enough hybrid hype that dealers are reluctant to negotiate on the purchase price. Beyond the current get-'em-while-you-can government rebates, zero per cent financing or cash-back incentives on hybrids in Canada are about as rare as free gas.

Hybrid operating costs also need to be heeded.

Do you drive at the speed of traffic on the highway in less than ideal conditions (i.e., when it's windy and the road is hilly?) Or live in a climate where you use your car's defroster or air conditioning (which, here in Ottawa, where we go from winter frost to summer humidity over lunch, is about 365 days of the year)? Using the condenser in the A/C system uses more power, which uses more fuel.

If this sounds like your driving lifestyle, you can pretty much forget about achieving the typically surreal fuel consumption estimates that most hybrids claim.

Costs Surge for Building Power Plants

"There's massive inflation in copper and nickel and stainless steel and concrete," said John Krenecki, president and chief executive of GE Energy. The uncertainty is not just in nuclear plants, he said; coal plant prices are now similarly unstable.

As talk of building new power plants rises sharply, so does the cost. A new fleet of coal-fired power plants and a revival of nuclear construction after three decades are both looking tougher lately.

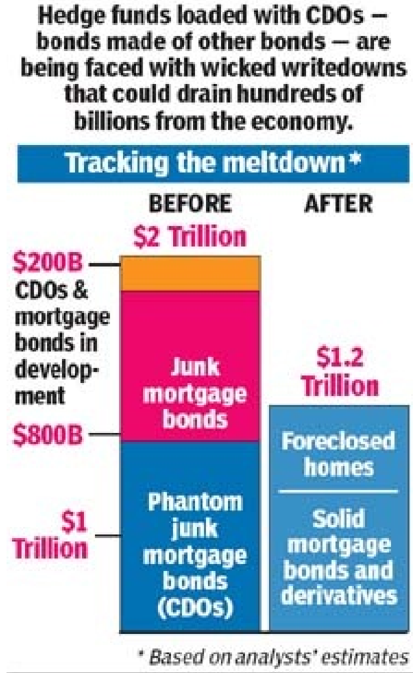
[Costs Spiral for LNG Projects]

> To place it into context, Shtokman's estimated reserves of 3.2 trillion cubic meters translate to about 113 trillion cubic feet, or the amount of gas the entire U.S. economy consumed over the past five years.
>
> This is a smart move on Gazprom's part because the estimated development cost of $20-30 billion is probably a fraction of what it will ultimately turn out to be. Many projects that resemble Shtokman in scope and complexity are struggling with major cost overruns.
>
> This plays right into the hands of companies like Chicago Bridge & Iron, Foster Wheeler, and the infamous Iraq contractor Kellogg Brown and Root (KBR — recently spun out of Halliburton). The stocks of these companies are expensive for good reason: They're all big players in the engineering and construction of LNG liquefaction terminals, so their businesses will benefit as this market grows and continues to experience cost inflation.

[Cheap goods keep China's surplus soaring]

> The news is full of headlines about tainted Chinese-made toothpaste and faulty Chinese-made tires. The U.S. Congress rings with indignant cries about Chinese product piracy and Chinese currency manipulation. Everyone is troubled about the flood of cheap goods pouring out of the teeming factories of China. Everyone, that is, except the people who are actually buying the stuff.
>
> Yesterday, China's trade surplus hit a new monthly high of $26.9-billion (U.S.), up 85 per cent from a year ago. That brought the surplus for the first half of this year to $112.5-billion, marking the first time it has exceeded $100-billion in a six-month period. If the economy keeps growing at this torrid pace, China's total trade - exports plus imports - will reach more than $2-trillion this year.

[Hedge Horror: Subprime meltdown could wipe out billions]



Graphic from the NY Post

> As home foreclosures ricochet through Main Street in rising junk mortgage meltdowns, Wall Street is facing a separate barrage that could swamp its first rich victims - hedge funds for the wealthy.
>
> The financial industry yesterday got more unhinged following a shake-up a day earlier when two credit-rating agencies stripped away the fragile masks of shaky mortgage securities, exposing their worthless sides.
>
> The stunning formal disclosures, which eventually could affect as much as $2 trillion in various mortgage securities, is expected to trigger widespread revaluation of the paper, which some analysts believe could wipe out 40 to 50 percent of their values.
>
> **For hedge funds, it would mean having to cover losses by giving back money to clients, even if it means selling off other good assets at a discount to raise money.**
>
> "The hedge funds are so over-leveraged, they'll be the first to crack," said Peter Schiff, CEO of Euro Pacific Capital.
>
> (emphasis added)

This is how a downward spiral begins, especially in a leveraged environment. Good assets have to be sold to cover the losses on bad ones, which further depresses prices and puts more investors underwater. This can trigger what amounts to a self-reinforcing flood of margin calls.

[Another pounding]

> When the man approaching you is wearing boxing gloves, it makes sense to duck. The crisis in the American subprime-mortgage market was clearly visible months ago. Too

many homebuyers with a poor or non-existent payment record were lent too much money. But when the rating agencies on July 10th finally got round to acknowledging the problem, investors were clobbered. Shares briefly wobbled and the dollar sank. Swap spreads, a measure of risk aversion, reached their highest point since 2003. Credit derivatives, where much of the financial innovation in recent years has taken place, recoiled (see chart). Investors flocked to the haven of Treasury bonds.

Why were investors so slow to react? It seems they have been consistently blindsided by how widespread the subprime problems have become—as well as complacent about the potential spillover into other areas of the debt markets.

Agencies Defend Hedge-Fund Oversight To Congress

The federal government doesn't have direct oversight of hedge funds - lightly regulated pools of capital that are able to use leverage, or borrowing, and tactics such as "shorting," or selling borrowed shares. Instead, federal overseers try to stay on top of hedge funds by working with the big banks and securities firms that provide financing to the hedge funds.

Managers: Subprime Blame Lies With Rating Agencies

Robert Rodriquez, chief executive officer of First Pacific Advisors, was even more blunt. "We haven't seen much of a problem in the subprime area [but only] because the pricing is a fraud; the ratings are bullshit," said the two-time recipient of Morningstar's Fund Manager of the Year.

"I don't buy these prices, but as long as someone can provide capital to keep the finger in the dike, the charade will go on."

Rodriguez concurs with Gundlach that rising subprime mortgage delinquencies are a problem not just for hedge funds but also for major banks and other financial institutions.

Subprime's Black Tuesday?

The ABX index is a way of measuring credit risk in the market for subprime mortgage-based securities. On Tuesday morning, one of the three big credit-rating agencies, Standard & Poor's, announced that it may soon downgrade the credit status of about $12 billion worth of such securities. Most of it is stuff that could well and truly be considered toxic waste -- bonds that are tied to the value of mortgages issued by such illustrious brokers as New Century Finance Corp. (now in bankruptcy proceedings) and Fremont General (forced by the SEC to sell its subprime lending business). But Standard & Poor's also announced that it was going to review its procedures for rating the rest of the hundreds of billions of mortgage-backed securities out there, which is making Wall Street worry that more bad news is yet to come. Thus the free fall in the ABX index. Risk is suddenly risky!

Subprime Losses Drub Debt Securities as Ratings Drop

> More than a few investors would like to know what took the New York-based rating companies so long to discover a U.S. liability of Iraq-sized proportions.
>
> "I track this market every single day and performance has been a disaster now for months," said Steven Eisman, who helps manage $6.5 billion at Frontpoint Partners in New York, during a conference call hosted by S&P yesterday. "I'd like to understand why you made this move now when you could have done this months ago."

U.S. Foreclosures Increase 87 Percent as Prices Fall

> Foreclosures are soaring amid a glut of properties and as interest rates close to an 11-month high make it more difficult for borrowers to refinance. Defaults may rise further as owners with adjustable rates see their payments soar. The share of people taking out all types of adjustable-rate home loans averaged 29 percent during the past three years, compared with the 17 percent average of the prior three years, according to Freddie Mac data.

U.S. home prices expected to rebound in 2008

> U.S. home prices are expected to recover in 2008 with existing-home sales picking up late this year and new-home sales rising early next year, the National Association of Realtors (NAR) said Wednesday in its latest forecast.
>
> The NAR expects existing-home sales to total 6.11 million units this year and 6.37 million in 2008, down from 6.48 million last year. New-home sales are projected at 865,000 units in 2007 and 878,000 next year, compared with 1.05 million in 2006.

U.S. FDIC chief looking at banks' CDO exposure

> CDOs are investment-grade securities that are created by bundling together portions of loans, mortgage-backed bonds, municipal debt, credit card receivables or other securities.
>
> CDOs that include subprime mortgages rose in issue volume to about $189 billion last year from just over $100 billion in 2005, according to Barclays Capital....
>
> ...."It's going to get worse before it gets better. How much worse, I don't know," Bair said. "Going forward, investors really need to be paying attention to what they're buying. And rating agencies need to be carefully evaluating these mortgages backing these pools."
>
> In the third and fourth quarters of 2007, many subprime mortgages are scheduled to reset to higher rates, which could trigger more defaults, she noted. "Clearly, the direction of interest rates and the direction of home prices is going to affect a lot of this."

More Subprime Woes to Come

> In 2006 about 12% of subprime borrowers grappling with interest rate hikes went delinquent or lost their homes. Now, with house prices dropping and lenders toughening standards for new loans, even more defaults are likely. "For the next 12 months it's just going to get worse," says Andrew Lahde, a money manager at Santa Monica (Calif.)-based Lahde Capital Management who is betting mortgage securities will fall in value. Janet Tavakoli, a consultant on mortgage-backed securities, thinks the rating agencies are still too optimistic: "No one really knows how many really bad [loans] were put out there," she says. S&P Managing Director Thomas J. Warrack says the agency is in fact being more watchful than in the past because of the unprecedented risks. Says David Teicher, a Moody's managing director: "We call 'em as we see 'em."

Debt Market Woes: ARMs Are The Next Shoe To Drop

> With 1) delinquency rates above 13% at the end of 2006, and 2) tens billions of $ of currently performing subprime U.S. mortgages about to hit their rate reset date, downgrading seems like an appropriate - if embarrassingly tardy - thing to have done. Some of the downgrades hit bonds backed by mortgages issued by firms (Fremont Investment & Loan and New Century Mortgage Corp., for example) that had gone in the tank months ago.
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> You've got to be a rosy credit analyst to think that a lending firm can go bankrupt due to issues with their loan customers and funders, but that loans provided by the defunct firm aren't worth a review (see our post "Sub prime market not so sublime", March 12-07) around the time of the lender's own tipping point.
>
> The bonds downgraded (or placed under review) by Standard & Poors include three that were previously rated AA, and 88 that were formerly in the A category. More scary for the pension fund crowd are the 366 that were formerly BBB-rated, which in many cases means that the bond in question is no longer "investment grade" if it is dropped two notches (from BBB to BBB minus to BB+). This will ensure that some funds might be forced to sell, by the terms of their investment policy, these formerly BBB-rated bonds once they slide to sub-investment grade status.

Roof caves in

> Wall Street is bracing for a nearly $2 trillion washout over the collapse of hollow and shaky mortgage bonds, triggering fears of a recession worse than the dot-com bubble bursting.
>
> A stunning first step in that grim outlook came yesterday when two credit rating agencies - Standard & Poor's and Moody's Investors Service - abruptly pulled the plug for the first time on a protective layer of respectable ratings that have cloaked the underlying, deep weaknesses of mortgage securities awash in the economy.

Mortgage vultures swoop on US housing crisis

"These companies are like sharks biting into prey. They are looking to see if there is any equity in the house, if there is any fat on the bones. If there is, they strike.

"They bombard the aged, jobless and disadvantaged, people with debt or health problems, with phone calls, mail solicitations and personal visits. And some people are so desperate that in a weak moment, they accept the offer of so-called help."

Mr Morris's case is typical of those being reported across America as "rescue" schemes take advantage of the homeowners' vulnerability. The complex mortgage loan documents are written in such dense language that five in 10 borrowers cannot tell how much they are borrowing, according to the Federal Trade Commission.

As calls for federal legislation grow, Massachusetts became the latest state to act last month when it banned all "rescue" schemes that entice homeowners to transfer their deeds to a supposedly temporary purchaser.

"We've seen no instances where they actually help and they are rife with fraud and abuse," said Christopher Barry-Smith, the head of the state Consumer Protection Division, who added that dozens of "foreclosure rescue artists" operated in Massachusetts.

“Debt Time Bomb” Set to Explode in United Kingdom

While Britons continue to borrow more and spend more, the national savings rate has plummeted into negative territory—the worst level since records began in 1960. Even including employers’ contributions to pensions, the national savings rate is only 2 percent. Officially, inflation in Britain is running at around 2.5 percent, which means that even with employer contributions, the average Briton’s savings are eroding, as families are choosing to dig into their savings to finance their everyday spending.

Personal debt levels in Britain have ballooned so quickly (hitting a record £1.38 trillion) that the British Tory party initiated an investigation to determine why Britons on average owe twice as much as continental Europeans.

Such widespread debt levels are dangerous. Adjustable-rate mortgage time bombs resetting en masse over the next year will exacerbate the situation.

Huge increase in those forced to default on mortgages payments

A spokesman for the CML said it was revising upwards its forecast of 18,000 repossessions this year. The two million people whose fixed-rate deals will come to an end in the coming 18 months are expected to endure the most pain. "There's a big squeeze coming up. Not because interest rates are particularly high but because of the pace of the rises in the past six months, which will catch people on the hop," the CML said.

Although treble what they were three years ago, repossessions are a quarter of the rate they were at their peak of 75,000 in 1991 when millions of people found themselves in negative equity - with properties worth less than their mortgages. But a time lag means that it may be several months before the true scale of problems emerges in 2007 and

2008.

[On borrowed time: markets stare into abyss]

Falling bond prices mean rising yields, and that means higher borrowing costs for everyone. Analysts fear a whole bath of bubbles could be about to go pop.

The jump in yields is the end of a long, long story. During the aftermath of the dotcom crash five years or so ago, central banks around the world slashed interest rates to cushion their economies against recession. They kept borrowing costs low for years, encouraging consumers and companies to pile up a mountain of cheap debt.

Since the global economy has recovered, and inflation has picked up, central banks have pushed up the short-term rates they can control. Yet the cost of longer-term borrowing, determined in the markets by how much investors are willing to pay for bonds, has stubbornly refused to rise. Former Federal Reserve chairman Alan Greenspan called this a 'conundrum'.

Over the past few weeks, this long-running puzzle has finally begun to be resolved. Stung by losses in the US sub-prime mortgage market, and nervous about continuing high inflation, investors have become much less keen on paying high prices for potentially risky debt. Bond prices have plummeted; yields have shot up.

Central banks have been warning for some time that investors may be paying too much for risky assets. In a normal market, investors want to pay lower prices for longer-term or riskier debt, in order to allow for future inflation, or default; but the 'spreads' between the yields of different bonds have been tiny in recent years. Since the losses suffered during the sub-prime crisis, however, many investors have responded by rethinking how much risk they are willing to carry in their portfolios.

'I think greed is switching to fear,' says Julian Jessop, of Capital Economics. 'Even if you don't have any exposure to sub-prime, you might look at your portfolio, and think, "maybe I'm paying too much".'

This process is already having powerful knock-on effects. The higher bond yields are, the more expensive it is to borrow money. Suddenly, the calculations for a whole range of debt-backed investments and deals look different....

....The consequences of a sudden wrench in debt markets may be impossible to predict; but they will certainly be widespread, hitting any market where investors have borrowed in order to bet. 'Almost every market has benefited from increased risk appetite,' says Jessop. 'Things like the M&A boom of recent years will probably come to an end.' Roger Bootle, economic adviser to Deloitte and Touche, has warned that even top-notch wines and fine art could be vulnerable, as the flood of cheap money dries up.

As Bank of England governor Mervyn King put it in a recent speech: 'Excessive leverage is the common theme of many financial crises of the past. Are we really so much cleverer than the financiers of the past?'

[Investors' flight from risk picks up pace]

> Investors in European and US credit markets accelerated their flight from risk on Wednesday as the turmoil from the US mortgage markets continued to spill over into other asset classes.
>
> The change in sentiment, which triggered sharp moves in credit derivatives markets, suggested that recent problems in the subprime mortgage sector could be spreading to other corners of the financial world.

Stocks close higher as investors play down concerns over subprime market

> The TSX financial sector was down 0.18 per cent. The sector has suffered recently in part over investor worries about Canadian exposure to the U.S. subprime market. On Tuesday, CIBC said its unhedged exposure to the market is well below some media estimates of US$2.6 billion.

Canada's housing market keeps on booming

> Canada's resale housing market is still firing on all cylinders, with dollar volumes, new listings and the average price of a home racing to record highs in June.
>
> The report arrives one day after the Bank of Canada raised interest rates for the first time in more than a year, and as the housing market south of the border is mired in a deep slump, threatening U.S. economic growth and corporate profits.