Weekly Updates Issue # 751

1. Weekly Markets Changes

[February 14, 2020]

S&P TSX	S&P 500	Dow Jones	NASDAQ	CAD/USD	Gold	WTI Crude
17,848.36 +192.9 +1.09%	3,380.16 +52.5 +1.58%	29,398.08 +1,142.1 +4.0%	9,731.18 +210.7 +2.21%	$0.7548 +0.32c +0.43%	$1,584.06 +13.62 +0.87%	$52.05 +1.73 +3.44%

2. Investors may be locked in extended low-yield cycle

[February 13, 2020] While the risk of a recession remains relatively low, the real challenge for investors will be finding yield as low interest rates become the norm in a self-perpetuating cycle, a FTSE Russell fixed income expert says.

Speaking at a breakfast event Thursday hosted by the Canadian ETF Association, FTSE Russell fixed income research director Robin Marshall showed a number of charts pointing to the “Japanification” of bond yields across G7 countries.

“The evidence from Japan is relatively strong that this decline in yields may well continue,” Marshall said, adding that low interest rates have the potential to self-perpetuate.

“If you drive interest rates down to zero, you tend to prop up zombie companies and banks that probably shouldn’t be allowed to exist,” he said.

Near-zero interest rates makes it harder for financial institutions that are required to match long-term liabilities with suitable assets. The low rates drive up liabilities, requiring institutions to buy more low-yielding assets to match those liabilities, he said, “which in turn causes yields to decline again, which in turn causes liabilities to increase.”

Longevity risk adds to the pressure, as people live longer and spend less, putting stress on pension systems, while purchases of long-dated assets further contribute to lower yields.

"The process becomes self-feeding and you have a financial system that is hard-wired to very low rates," Marshall said. "There's almost a spiral downwards in yields."

This also increases the risk of a "liquidity trap," where central banks lowering rates no longer leads to increased spending.

Marshall said investors haven't yet adjusted to the new low-rate norm, having anchored expectations to bond yield ranges from the 1980s and 1990s.

While growth may be slower and yields flat in the coming years, Marshall said a recession is not necessarily imminent.

Markets responded to the yield curve on U.S. 10-year and two-year Treasuries inverting last year, but the picture was incomplete, he said. The long end of the curve also inverted ahead of previous recessions, he said, and that hasn't happened with 20-year Treasuries.

"Recession risks, in our view, are lower than what we're seeing in a cursory examination of the yield curve having flattened," Marshall said.

The coronavirus notwithstanding, he said the risk of a recession in the near term is low.

3. Debt servicing is better metric for measuring financial risk, report says

[February 13, 2020] Financial regulators should be paying attention to households' debt servicing capacity in assessing the buildup of financial risk, argues the C.D. Howe Institute.

In a new report, the Toronto-based think tank said that including household debt servicing (the debt service to disposable income ratio) in assessments of financial risks improves the ability to detect household financial stress, particularly ahead of recessions.

"By focusing on debt servicing rather than debt, the [report's metric] appears to yield fewer false positives than the Bank of Canada's barometer," it said.

It also reported that, at this point, its measures of financial vulnerability indicate that risks remain low, despite the buildup in household debt.

"Focusing on debt servicing provides a potential clue as to why we have not seen the type of market correction that has been repeatedly predicted for the Canadian housing market," the report said, noting that, "the debt-service-to-disposable-income ratio has largely been flat."

The paper also argued that financial sector regulators and policymakers should be paying more attention to debt servicing metrics in their assessments of financial risks and setting monetary policy.
"If financial stability is taken into consideration in the setting of monetary policy, central banks must be concerned with the trade-off between the short-run positive effects of increased borrowing on output and inflation and the potentially negative long-run effects that work their way through the debt-service channel," it said.

4. Half of Canadians put off retirement saving, survey finds

[February 11, 2020] Nearly half of Canadians have delayed saving for retirement — or have not started saving at all — according to a survey commissioned by Toronto-based Oaken Financial.
The survey found that 50% of Gen X workers (aged 35-54), 54% of millennials (aged 18-34) and 36% of baby boomers (aged 55 and over) have delayed saving for their retirement due to a high cost of living, suggesting that the current workforce will face a retirement funding shortfall.
Costs associated with raising children and student debt were also factors that delayed respondents' retirement saving. Forty-seven per cent of millennials and 38% of Gen Xers said that child-related costs were a financial burden. Additionally, 40% of millennials and 24% of Gen Xers said student debt has made it difficult for them to save for retirement.
When respondents were asked if they have had to make sacrifices in their lifestyle to assist children financially, 48% of boomers said they had, compared with 64% of millennials and 62% of Gen Xers.
Additionally, 29% of millennial respondents said they were financially responsible for both their parents and their children. Of this group, 36% said this had caused a strain on their finances.
Millennials (30%) and Gen Xers (24%) were more likely to be counting on an inheritance than boomers (17%). Half of respondents indicated they had no intention of leaving an inheritance for their loved ones and said they were either already spending their money or intended to spend their money to support their own retirement.
Oaken Financial is a primarily online financial institution offering high-interest savings accounts and GICs. The online survey, conducted by Leger, polled 2,003 Canadians over the age of 18 between Oct. 3 and Oct. 14, 2019. Online surveys cannot be assigned a margin of error because they do not randomly sample the population.

5. Young, well-heeled immigrants drive Canadian housing boom

[February 11, 2020] The booming Canadian housing market has long been a concern for policymakers and market watchers alike. Yet, new research argues that the market is being powered by Canada's success at boosting its productive population through immigration, not reckless lending.

In a new report, analysts at National Bank Financial Inc. (NBF) said that, while the U.S. housing market boom that ultimately led to the financial crisis and a global recession was driven by a reduction in lending standards, that is not the case in Canada. In fact, "the Canadian boom has taken place despite a tightening of regulatory conditions," the report said.

Tougher regulation has included the introduction of stress testing requirements, along with a reduction in maximum amortization periods and higher down payment minimums for insured mortgages. These measures helped slow housing markets initially, but home sales rebounded strongly in 2019, NBF said.

While lower interest rates are one factor behind the rebound, NBF said Canada's housing boom is also being driven by the country's demographic trends — particularly strong immigration.

"Canada's population has been among the fastest-growing of the OECD countries for years now. But last year's 1.4% gain was exceptional, the highest in almost three decades," the report said, noting that over 80% of the increase was driven by immigration.

Moreover, immigrants to Canada are unusually young, well educated and well-heeled.

"Immigration to Canada stands out not only for its volume but for its composition," the report said.

The report noted that about 60% of the annual inflow of permanent residents to Canada are "economic" immigrants, who are selected for "their ability to become economically established."

"Canada is now undeniably the biggest talent raider in the OECD," NBF said.

Additionally, immigration to Canada is increasingly concentrated in the 25-to-44-year-old age group, which drives household formation, the report noted. Growth in this age group is correlated with higher housing prices.

Looking ahead, the report said that these trends are expected to continue, with the Canadian government looking to increase immigration.

"Statistics Canada projects that the 25- to 44-year-old cohort will grow 6.9% over the next 10 years," the report said. "In other words, the vigour of the

Canadian housing market is soundly based and set to continue confounding the skeptics."

6. Insolvencies surged in 2019

[February 11, 2020] In 2019, total insolvencies hit their highest level since the immediate aftermath of the global financial crisis and recession, according to a report from Scotiabank Economics.

"Through the year, consumer insolvencies trended upward on the backdrop of rising household debt burdens, sparking concern over the ability of households to manage their debt," the report said.

Despite the high annual total, new insolvencies declined for the second straight month in December.

Consumer insolvencies were at their lowest level since January 2019, Scotia said in the report, noting that this "follows a rather stable — though recently weakening — macroeconomic picture accompanied by strength in employment, and favourable borrowing rates as the Bank of Canada keeps the overnight rate on hold."

Still, on a seasonally adjusted basis, new insolvencies were up on both a month-over-month and year over-year basis in December.

"The rise in the seasonally-adjusted trend emphasizes that the lower number of insolvencies in December is still high," the report said.

The report also noted that defaults on larger debts "such as mortgages, HELOCs, and lines of credit remained relatively low through the year."

The report added that Canadians aged 65+ "have the highest share of mortgage loans in arrears."

With mortgage delinquencies remaining low, defaults on auto loans increased in 2019.

On the business side, the insolvency trend "remains on an overall declining trajectory in the period following the Great Financial Crisis as the stability of interest rates continues to stimulate repayment on larger loans," the report said.

7. Air Italy stops flying and goes into liquidation

[February 11, 2020] Air Italy has suspended operations after its owners decided to liquidate the company, leaving customers with flights booked after February 25 in the lurch.

Italy's second biggest airline after flag carrier Alitalia said Tuesday that the decision to wind up the company was made at a meeting of its shareholders.

Alisarda, founded by the Aga Khan, controlled 51% of Air Italy, while Qatar Airways had a 49% stake in the company.

In a statement, Qatar indicated that it would have been ready to invest more in the airline.

"Even with the changing competitive environment and the increasingly difficult market conditions severely impacting the air transport industry, Qatar Airways has continually reaffirmed its commitment, as a minority shareholder, to continue investing in the company," Qatar said in a statement.

It added: "Qatar Airways was ready once again to play its part in supporting the growth of the airline, but this would only have been possible with the commitment of all shareholders."

Air Italy, previously known as Meridiana, said that flights from Tuesday through February 25 would be operated by other carriers. Flights booked after that point will be refunded.

The airline, which was based in Sardinia, operated flights throughout Italy and to long-haul destinations including New York, Miami and Los Angeles. It also offered direct flights from Italy to locations in Africa, including Cairo and Lagos.

Air Italy is the latest in a string of European airlines to suffer from fierce competition and shifting business models. Primera Air ceased operations in October 2018. In February 2019, German airline Germania filed for bankruptcy and British airline Flybmi stopped flying. Icelandic budget carrier Wow Air left passengers stranded when it suddenly ceased operations a month later.

Meanwhile, the Italian government has being propping up Alitalia while it looks for investors to relaunch the company, according to Reuters.

The grounding of Boeing's 737 Max plane has added to pressure on the industry. Air Italy had three Boeing 737 Max jets in its fleet. And the coronavirus — which has caused dozens of carriers to cancel flights to China — has injected further uncertainty into the outlook for the aviation industry. Fewer Chinese tourists and a shock to the global economy from a slowdown in China would hit demand for flights.

8. Changes may be coming to mortgage stress test

[February 10, 2020] Homebuyers stressing over the mortgage stress test — and sellers stressed about the test's negative effect on demand — could soon have their concerns eased. That's because changes to the stress test may be in the works, given that the housing market is stabilizing.

“Governments now are toying with the idea of playing a little bit with that test, making it a bit easier, maybe more flexible,” said Benjamin Tal, managing director and deputy chief economist at CIBC Economics, in a Jan. 27 interview.

Last December, Prime Minister Justin Trudeau’s mandate letter to Finance Minister Bill Morneau listed several priorities, including a review of the stress test and recommendations to make it “more dynamic.”

The stress test was expanded in 2018, when the Office of the Superintendent of Financial Institutions updated its Guideline B-20 in response to an overheated housing market. As a result of the updated guideline, new buyers with down payments of 20% or more must qualify at either the five-year benchmark rate published by the Bank of Canada or the lender interest rate plus 2% — whichever is higher. Since 2016, new buyers with less than 20% down have had to qualify at the central bank’s five-year rate.

The B-20 update was “aimed at slowing down demand for housing, and it seems that it worked,” Tal said. “The market slowed down notably in 2016, 2017 and early 2018 — until now.”

In 2017, average home price increases approached 20% year over year, noted a report by Tal last fall. That figure dropped to about 2% in November 2019. He described the correction as “healthy,” especially in pricey urban centres like Toronto and Vancouver.

Toronto’s market is now stable, and Vancouver’s is “in the ninth inning of the correction,” Tal said. As of last month, Canadian home prices had rebounded nearly 5% from the previous year’s lowest point, according to the Aggregate Composite MLS Home Price Index.

While Tal noted that home prices vary by region — Alberta’s housing market continues to suffer along with oil prices — Canada’ housing market overall has recovered from various policy measures, including B-20. “This is a market in equilibrium,” he said.

As such, he supports changes to the stress test.

“This test is not flexible enough,” he said.

“Regardless of where we are in the cycle — if interest rates are low or interest rates are high — you apply the same 200 basis points, which is suboptimal,” he said.

Further, those 200 basis points are applied to the central bank benchmark rate, which is relatively high compared to the discounted rate that homebuyers typically receive. The result: the stress test is “too much,” Tal said.

“We need to change B-20 in a way that makes it more flexible and consistent with where we are in the cycle.”

While he forecasted that regulators will ease the test, he doesn't expect big results.
Any easing "will be positive for demand, but it will not change the way the market is operating," he said.
That's because demand isn't the main reason why prices are rising. Instead, the culprit is "the lack of supply in places like Toronto, Vancouver — even Montreal," he said.
Still, Tal said, "to the extent that the regulators will ease B-20, that will be a net positive for overall demand for housing in Canada."

9. People with higher incomes are filing for insolvency

[February 10, 2020] More prosperous households are filing for insolvency, according to a study released on Monday by Hoyes, Michalos & Associates Inc., a licensed insolvency trustee based in Kitchener, Ont.
According to the study, insolvent debtors saw their average household income rise by 5.5% in 2019 to $3,152 a month after tax, but expenses grew by 6.4%. That left the average insolvent debtor with $264 a month to put toward debt repayment — down from $273 in 2018.
"More households have fewer funds available after paying for rising living costs to meet debt obligations," Ted Michalos, co-founder of Hoyes, Michalos & Associates, said in a statement. "Combine this with high, pre-existing debt, and you have a debt repayment problem."
The average consumer debt balances among insolvent debtors increased by 1.9% in 2019, from $57,840 to $58,923.
While credit card debt decreased two percentage points to 30% as the primary debt in consumer insolvencies, the study found a continuing rise in payday or fast-cash loans, high-cost financing loans, student debt and vehicle financing.
The number of insolvent debtors who carried at least one loan from a high-cost payday lender increased to 39% in 2019, up from 37% one year earlier.
Personal loans increased by 8.7%, driven by high-interest financing loans that carry an interest rate between 39% and 49%. More than one in 10 debtors (11.4%) had a shortfall on a vehicle loan, up 10.2% year over year.
Young Canadians are struggling most, with those under the age of 40 accounting for 47.1% of all insolvencies, the study found.

10. Debt destroys relationships

[February 10, 2020] With the most romantic day of the year fast approaching, a new survey from Credit Canada finds that 33% of Canadians have either ended or would end a relationship because of their or their partner's debt.

The leading reasons respondents cited for calling it quits was a lack of financial honesty (71%) followed by poor money management or spending habits (48%). Only 13% of respondents said they'd end a relationship because of their partner's income level.

Financial issues were more likely to force women to end a relationship than men.

Three quarters of women (76%) said they have or would break up with their partner over a lack of financial honesty, compared to 65% of men. Similarly, 52% of women said they have ended or would end a romance due to poor money management, compared to 44% of men.

The survey also found that debt is negatively impacting Canadians' lives, with respondents saying they are losing sleep (34%), avoiding social gatherings (32%), have less motivation (19%) and are limiting friendships and relationships (13%) because of debt.

The findings were based on an online poll of 1,552 Canadians conducted by Angus Reid from Jan. 29 to 30, 2020. Online surveys cannot be assigned a margin of error because they do not randomly sample the population.

Have a nice and fruitful week!