Weekly Updates Issue # 595

1. Weekly Markets Changes
2. How asset managers are adapting to fragile bond liquidity
3. B.C. offers five-year, interest-free down payment loans to first-time buyers
4. On the rise: mortgage-to-income ratios above 450%
5. Home sales expected to drop in 2017
6. Household debt still rising, reaches another record
7. Canadian pension funds strike $545-million deal
8. Will parents benefit from new childcare framework?
9. Loonie surges past 76 cents U.S. on oil price gain

1. Weekly Markets Changes

[December 16, 2016]

S&P TSX	S&P 500	Dow Jones	NASDAQ	CAD/USD	Gold	WTI Crude
15,252.20 -60.00 -0.39%	2,258.07 -1.46 -0.06%	19,843.41 +86.56 +0.44%	5,437.16 -7.34 -0.13%	$0.7496 -0.90¢ -1.19%	$1,136.80 -24.60 -2.12%	$52.03 +0.55 +1.07%

2. How asset managers are adapting to fragile bond liquidity

[December 15, 2016] The BoC says liquidity in the corporate bond market remains fragile as portfolio managers use new trading tactics to reduce risks.

The central bank, in its report Thursday analyzing risks to the Canadian financial system, identified fragile corporate bond liquidity as a key vulnerability, along with household indebtedness and elevated housing prices relative to incomes.

In response to bond liquidity risks, fixed income managers have “fundamentally altered” their trading, the BoC says, as regulatory reforms have helped to reduce the risks that dealers take on their balance sheets.

Important bond dealers such as banks, for instance, have shifted from principal trading to agency trading, where they match clients directly with corporate bond buying and selling without temporarily bringing the securities onto their balance sheets.

Asset managers have also adapted by holding more recently issued securities and increasing their investment horizon for assets with liquidity issues. They are making trades less frequently and dividing big orders into smaller, multiple trades, the BoC says.

Prab Sagoo, associate director at Nasdaq Advisory Services, tells Advisor.ca that corporate bond liquidity has become more of an issue amid higher underlying volatility, brought on in part by automatic trading programs and other quantitative models.

"I think it's very much understandable and feasible that these asset managers, the banks and all the trading desks want to take some of the risk off their books," says Sagoo.

The BoC says some securities dealers are also using ETFs to source corporate bonds and help manage inventories. The central bank suggests there is a risk, however, that if ETFs "and other asset managers were required to sell large quantities of fixed-income assets to meet redemptions, this could put stress on market liquidity."

Some dealers are even seeking returns on the liquidity shortages, the BoC says: "Some of the most active buy-side market participants are also taking advantage of the new environment by supplying liquidity (offering to transact bonds that others have a strong need to buy or sell) when this can generate a substantial return."

The BoC cited its survey of 200 firms on fixed income during the summer. It found general concerns about bond liquidity during periods of market stress and bigger worries about liquidity in the corporate bond market.

While the corporate bond market has withstood big stress events, such as the U.S. election and the Brexit vote, "it is difficult to ascertain how well this evolving market structure will withstand unpredictable and longer lasting shocks," the BoC says.

The bank adds that it has observed no significant deterioration in the functioning of fixed income markets since its last Financial System Review, released in June.

Sagoo says bond liquidity could become an issue if a large financial shock caused financial institutions and investors to stop lending to one another.

"The pre-crisis period may not be the best standard for comparison, because liquidity was excessive and virtually costless at that time," BoC Governor Stephen Poloz says. He adds that he expects market players to continue to adapt within a more resilient financial system.

3. B.C. offers five-year, interest-free down payment loans to first-time buyers

[December 15, 2016] British Columbia's government wants to help first-time homebuyers get into the market by offering interest-free and payment-free loans for the first five years.

Premier Christy Clark says the government will provide first-time homebuyers with a 25-year loan for a down payment on a home to a maximum of $37,500, as long as the funds have been matched by buyers.
She says the program applies to homes with a maximum value of $750,000 and the interest-free portion of the loan will last for the first five years, with the repayment schedule at current interest rates over the remaining 20 years.
Clark says the program will start accepting applications online next month.
To be eligible, first-time buyers must be pre-approved for an insured high-ratio mortgage for at least 80% of the home's purchase price.
The announcement comes as housing costs in the province have ballooned, especially in Metro Vancouver where the average price on a single-family home in some neighbourhoods reached $2 million.

4. On the rise: mortgage-to-income ratios above 450%

[December 15, 2016] The BoC expects changes to the mortgage rules to help ease a persistent rise in highly indebted borrowers in Vancouver and Toronto.
The central bank warned Thursday that the still-climbing levels of debt–and the growing proportion of highly indebted households in many cities amid low interest rates–have opened up a larger weak spot in Canada's financial stability.
In its latest financial system review, the bank says at a national level the proportion of highly indebted borrowers with mortgage-to-income ratios above 450% reached 18% in Q3 2016, up from 13% two years earlier.
The report said high home prices have helped fuel growth in the proportion of these highly indebted borrowers in cities like Toronto, where in the last two years the loan-to-income ratio increased to 49% from 32%, and in Vancouver, where it rose to 39% from 31%.
"Households carrying high levels of debt could find it more difficult to adjust to a loss in income or other financial shock. They may be forced to sharply cut back on their spending and, in severe cases, may default on loans," the BoC said.
But the bank predicted that stricter housing finance rules introduced in recent months by federal, provincial and municipal authorities will help ease household indebtedness and improve the quality of future borrowing.
In October, the federal government announced changes aimed at addressing hot housing markets and rising debt loads. Ottawa's new rules made it tougher for prospective borrowers to qualify for mortgages and restricted insurance eligibility for high-ratio mortgages.

The central bank also underlined new rules in Vancouver including a 15% tax on foreign buyers and a tax on homes that are left empty.

All of these measures appear to have somewhat eased concerns expressed by Bank of Canada Governor Stephen Poloz, who warned in June that surging housing prices in Vancouver and Toronto were outpacing local economic fundamentals in those areas like job creation and income growth.

"Accordingly, these policies will help mitigate financial stability risks over time," Poloz said in a statement that accompanied the report.

While the bank said the probability of an economic shock materializing remains low, it noted that such an event could have "significant" consequences for the economy and the financial system.

The report said that Canada's financial system also remains vulnerable to the continued rise in house prices across the country. The bank said real estate prices have hit a level of just under six times the average household income — the highest ever recorded.

At a regional level, it said housing prices remain particularly high in the Toronto and Vancouver areas. The Vancouver market, however, has begun to slow, the bank added.

Other risks for the financial system

The report also explored what it described as key risk scenarios — or "trigger events" — to the Canadian financial system. Overall, it said these risks were largely unchanged compared to the June report.

Among the identified risks, it said a large and persistent rise in unemployment across Canada would create financial stress on indebted families, reduce consumer spending and lead to housing price corrections, particularly in markets like Toronto and Vancouver.

While the probability remains low, the likelihood that country-wide financial stress and a housing correction will materialize had "increased modestly" since June, the bank said. The severity of such an event, should it occur, has also increased, it added.

The report also pointed to other risks, including stress out of China and other emerging markets, a sudden increase in long-term interest rates driven by changes in global economic conditions and a prolonged weakness in resource prices.

"Nonetheless, the Canadian financial system remains resilient," the bank said in a statement.

5. Home sales expected to drop in 2017

[December 15, 2016] The Canadian Real Estate Association is forecasting national home sales this year will be slightly higher than its previous estimates, with increased expectations for Ontario offsetting a decline for British Columbia.

The association says the number of sales this year is expected to rise 6.2% to 536,700 units, compared with an earlier forecast for a 6.0% increase.

Sales next year are expected to be 518,900 units, a drop of 3.3% compared with the revised forecast for 2016.

The association released its updated outlook as it reported home sales through its Multiple Listing Service fell 5.3% between October and November, the largest month-to-month decline since August 2012.

Compared with a year ago, sales volume in November was up 1.6%.

The national average price for a home sold in November was up 7.3% from a year ago, at $489,591. Excluding Greater Vancouver and Greater Toronto, the average price was $361,260.

6. Household debt still rising, reaches another record

[December 14, 2016] Statistics Canada says the level of household credit market debt rose to a record 166.9% of adjusted disposable income in Q3, compared with 166.4% in Q2.

That means Canadians owed $167, including consumer credit and mortgage and non-mortgage loans, for every $100 of disposable income.

Debt rose faster than incomes, with adjusted disposable income increasing 1.0% and household credit market debt growing 1.3%. The BoC has indicated household debt levels are a vulnerability for the financial system.

Total household credit market debt totalled $2.0 trillion at the end of Q3.

Consumer credit was $590 billion, while mortgage debt stood at $1.3 trillion.

Statistics Canada says the share of mortgage debt edged up to 65.5 per cent from 65.1 per cent in the second quarter.

7. Canadian pension funds strike $545-million deal

[December 12, 2016] Two of Canada's largest pension fund managers have reached an agreement to co-own a portfolio of New Zealand real estate.

Under the deal, the Canada Pension Plan Investment Board will buy a 50% stake in the portfolio from the Public Sector Pension Investment Board, which will continue to own the other 50%.

CPP Investment Board valued the deal at $545 million (NZ$580 million), subject to closing adjustments.

The 13 properties in the portfolio include a mix of office and retail space, primarily in Auckland and Wellington, N.Z.
CPP Investment Board invests funds on behalf of the Canada Pension Plan. As of Sept. 30, the CPP Fund had $300.5 billion of assets, including $38.4 billion in real estate.
PSP Investments manages retirement funds for the federal public service, Canadian Armed Forces, the Royal Canadian Mounted Police and the military Reserve Force. As of March 31, it had $116.8 billion of assets under management.

8. Will parents benefit from new childcare framework?

[December 12, 2016] A new study by the Canadian Centre for Policy Alternatives suggests, childcare fees in some of Canada's biggest cities has skyrocketed over the last three years, rising an average of more than twice the rate of inflation over the same time period.
The study adds the average monthly cost for full-time childcare has gone up by more than 8% across the country over the last three years. Much of that is the result of Quebec's decision to introduce a sliding scale for fees based on income in 2015, which saw average prices jump by 18%, but they still remain the lowest in the country.
Taking Quebec out of the equation, costs across the country have increased by more than 6%, more than double the average rate of inflation of 2.5% over that time, the study shows. What accounts for the increase in fees outpacing the cost of living has baffled researchers who have looked at the issue for years.
Martha Friendly, executive director of the Childcare Resource and Research Unit, says bringing down the cost of childcare in the rest of Canada would mean either cutting costs and staff, or increasing government funding. "There's no other way to reduce the cost of child care," said Friendly, who co-authored the study.
"One of the things that's absolutely clear from everything we know is that there has to be more government money because market costs for childcare do not work for families. They can't afford them."
Plans for childcare support
The 2016 federal budget earmarked $400 million next year for a childcare framework–a carrot the Liberals dangled to convince provinces and territories to sign on to the plan.
In a recent interview, Social Development Minister Jean-Yves Duclos told The Canadian Press that the Liberals have a plan to make a long-term funding

commitment in the 2017 budget to help provinces expand their childcare systems. But the exact dollar amount, and how the money will be used by provinces, is expected to be announced in that budget.
The study says families can end up paying more than $12,000 a year in some cities for a single child in daycare. In Toronto, monthly median childcare fees are $1,649; in Vancouver, $1,321.
Fee subsidies for low-income families offset some but not all of the cost. The study found out-of-pocket fees can range from $90 in Ontario up to almost $500 in Saskatoon and Calgary.
The study says the three provinces that set fees and directly fund services — Quebec, Manitoba and Prince Edward Island — have the lowest costs in the country, compared to provinces that let the market dictate fees.
"The best way to get low fees that are predictable is to set them and [then] make up the difference through direct transfers to providers" said study co-author David Macdonald, senior economist at the Canadian Centre for Policy Alternatives.

9. Loonie surges past 76 cents U.S. on oil price gain

[December 12, 2016] Oil prices soared following a weekend agreement to cut back production by 11 non-OPEC countries, pushing up the loonie.
January crude oil contracts were at US$53.63 per barrel as North American stock markets opened—up $2.13 from late Friday. Earlier, they traded as high as US$54.51 a barrel—a level that hasn't been seen since the middle of last year.
The Canadian dollar was at 76.14 cents US, up 0.27 of a U.S. cent from Friday. The loonie hasn't closed above 76 cents US since mid-October, according to Bank of Canada records.
The S&P/TSX composite index was up 59.80 points at 15,372.00 shortly after North American markets opened.
The Organization of Petroleum Exporting Countries reached a deal on Saturday that will see key non-member countries agree to cut 558,000 barrels per day for six months starting January 1.
That's on top of an OPEC decision November 30 to reduce member output by 1.2 million barrels a day.
A prolonged decline in global crude prices began in late 2014 after key OPEC members decided to keep production levels high, despite a worldwide oversupply.

In New York, the Dow industrial average was up 36.06 points at 19,792.91 and the S&P 500 was up 0.10 point at 2,259.63. The Nasdaq composite index was down 22.28 points at 5,422.22.
January natural gas contracts were down 21 cents at US$3.54 per mmBtu. February gold contracts were up $1.10 at US$1,163.00 and March copper contracts were down one cent at US$2.64 a pound.

Have a nice and fruitful week!