Weekly Updates Issue # 771

1. Weekly Markets Changes

[July 3, 2020]

S&P TSX	S&P 500	Dow Jones	NASDAQ	CAD/USD	Gold	WTI Crude
15,596.75 +407.77 +2.68%	3,130.01 +121.0 +4.02%	25,827.36 +811.8 +3.25%	10,207.63 +450.4 +4.62%	$0.7372 +0.60c +0.82%	$1,772.05 +0.76 +0.04%	$40.32 +1.83 +4.75%

2. Don’t expect ratings to stabilize this year, Fitch warns

[July 3, 2020] The risk to economic activity and corporate bottom lines in the months ahead is largely to the downside, says Fitch Ratings.

In a research note, the rating agency suggested that the downside risks to its base case are more significant than the upside risks.

In short, the agency sees the threat of a relapse in the economy as a more likely prospect than a faster-than-expected recovery.

“Consumer and corporate sentiment have been badly damaged. Just the possibility of further unpredictable resurgences will weigh down prospects for meaningful and — importantly — sustained improvement in confidence,” it said.

Against this backdrop, Fitch doesn’t expect ratings to stabilize this year where ratings facing negative outlooks.

Currently, more than one third of corporate credit ratings have a negative outlook, or are under a negative rating watch, it said.

Fitch noted that, historically, 50% to 60% of these ratings will experience further downgrades in the following 12 months.

3. Canada’s life insurance industry to contract 4.2% this year

[July 3, 2020] U.K.-based GlobalData has updated its growth forecasts for Canada’s insurance industry, with life insurance versus general insurance expected to be hardest-hit by the pandemic.

The data analytics firm expects Canada’s life insurance industry will contract 4.2% in 2020. That compares to the firm’s initial growth estimate of 4.7% pre-pandemic.

Canada’s total insurance industry is forecasted to contract 1.4% this year, a downgrade from an initial growth forecast of 3.8%.

General insurance accounts for 70% of Canada’s insurance industry, so the smaller life sector will help contain losses, GlobalData said in a release.

The data analytics firm also expects the market for general annuities to decline, forecasting a drop of 11.4% in 2020, versus a pre-Covid-19 forecast of 8.1% growth.

Its annuities outlook is based on the temporary freeze on portability transfers and annuity purchases of defined benefit pension plans, as announced by the Office of the Superintendent of Financial Institutions in March.

GlobalData noted the industry’s positive responses to the pandemic, such as the adoption of digitization to ensure remote connectivity with clients.

Further, “Insurers are doing everything they can to keep business going,” said Deblina Mitra, an insurance analyst at GlobalData, in the release.

“They are offering an extension to the grace period, and the waiving of missed payment fees or payment deferrals to individuals, families and businesses who are unable to pay premiums.”

4. Expect an increase in mortgage defaults

[July 3, 2020] Mortgage defaults are expected to rise in the wake of a deteriorating job market, says DBRS Morningstar.

In a new report that examines conditions in the Canadian housing market, the rating agency reported that residential mortgage growth was strong to start 2020, and was up 6.0% on an annual basis as of May.

While a variety of policy measures have been introduced to shore up market liquidity and keep credit flowing in the face of the Covid-19 outbreak, DBRS said that it “expects mortgage growth to decelerate significantly in the short term.”

Additionally, changes to the rules for insured mortgages that took effect on July 1 “will make it harder for the average family to qualify for an insured mortgage,” the rating agency said.

In terms of defaults, DBRS said that the credit quality of residential mortgages "is highly correlated" to local employment and housing market conditions. Rising unemployment and weaker house prices are both tied to rising defaults.

"Layoffs and lower income for hourly paid employees and for people who have been quarantined will put many households in financial hardship," DBRS said.

DBRS said that it expects "significant economic contraction" for Canada this year, with the higher unemployment rate "remaining elevated for the next two years as the economy recovers."

This, in turn, is expected to drive an increase in mortgage defaults, even as the big banks, other large lenders and the government have provided payment holidays and other measures designed to help troubled borrowers.

As for housing markets, sales started the year on a strong note, but plunged by 57.3% in April, and remained down by 34.7% in May, DBRS said.

While sales are expected to rebound as the economy begins to reopen, "there is still a great deal of uncertainty around the length of time it will take to recover as Canada works toward preventing a second wave of coronavirus cases," DBRS cautioned.

Additionally, trends such as weaker immigration, intensified household financial stress and more stringent mortgage insurance requirements "might affect housing demand in the longer term," the rating agency said.

At the same time, high household net worth will provide less of a cushion than it has in the past.

"Net worth as a percentage of disposable income decreased to 837% in Q1 2020 from 879% in Q4 2019, as the liquidity pull back in the equity markets affected global wealth," DBRS reported.

5. BoC warns of fraudsters posing as employees

[July 3, 2020] Canada's central bank is the latest institution to sound a warning about fraudulent activity.

The Bank of Canada said there's an apparent scam underway in which fraudsters claiming to work for the central bank contact victims about purported suspicious activity in their personal bank accounts.

In an alert, the central bank stressed that it doesn't accept deposits, request payments from individuals, collect personal financial information or participate in investment schemes.

Similarly, the bank said its employees don't request personal or financial information over phone, by email or through social media.

Numerous regulatory and law enforcement agencies have reported an increase in fraudulent activity during the disruptions caused by the Covid-19 outbreak, including investment frauds seeking to capitalize on the conditions created by the pandemic, phishing attempts and efforts to defraud government support programs.

6. Don't let low insolvency numbers fool you

[July 2, 2020] Amid ongoing government support efforts, insolvencies continued to decline in May, according to the latest data from the Office of the Superintendent of Bankruptcy Canada (OSB).

The agency reported that total insolvencies dropped by 8.2% in May from the previous month, and monthly insolvencies were down by more than 50% year over year.

"Debt payment deferrals and reduced operating capacity of Canadian courts gave debtors a temporary reprieve," noted Scotia Economics in a research note.

The number of bankruptcies declined by 3.9% month over month, and the volume of consumer proposals was down by 10.3%.

Compared with May 2019, consumer insolvencies plunged by 50.6%, and business insolvencies dropped by 38.9%, the OSB said.

With the decline in insolvencies during the Covid-19 pandemic, the total number of insolvencies for the 12 months ended May 31 was down by 2% from the prior 12-month period.

However, Scotia said that consumer insolvencies are expected to ramp up towards the end of the year.

"As Canadian households continue to experience high levels of unemployment this data remains out of sync with the reality of the financial struggle many are likely facing," Scotia said in its report.

"Through this period, many Canadian households have been able to defer payments on mortgages as well as other loans," and households have been able to rely on the Canadian Emergency Response Benefit to support essential spending, the report said.

"Instead of filling for insolvency, many households may be adopting a 'wait and see' mindset as rebounding consumer confidence indicates rising hopes for the future," Scotia said. "However, if the labour market does not recover by the time support measures expire, insolvencies will likely rise."

Additionally, as businesses face continued restrictions that limit their capacity and hamper revenues, "business bankruptcy filings are expected to rise if revenues do not recover," Scotia said.

7. China is storing an epic amount of oil at sea. Here's why

[July 1, 2020] China bought so much foreign oil at dirt-cheap prices this spring that a massive traffic jam of tankers has formed at sea waiting to offload crude.

As of June 29, China -- the world's second-largest consumer of oil after the United States -- had amassed 73 million barrels of oil on 59 different ships floating at sea off the country's northern coast, according to ClipperData, which tracks waterborne flows of crude oil in real-time. For context, that is three-quarters of the demand for the entire planet.

Barrels arriving today would have been purchased in March and April -- when oil prices were melting down because of the pandemic. US crude crashed below zero on April 20 for the first time ever.

China's so-called floating storage -- defined as barrels of oil on vessels waiting for seven days or longer -- has nearly quadrupled since the end of May, according to ClipperData. Not only is that the most on record going back to early 2015, it's up seven-fold from the monthly average during the first quarter of 2020.

The hoarding of oil at sea is a reflection of China's bargain-hunting during a time of extreme stress in the energy market.

"China went on a global buying binge," said Matt Smith, director of commodity strategy at ClipperData. "There is just this deluge of crude building up offshore."

And Smith noted that China's onshore storage tanks are not even close to being filled.

"This is simply related to terminal congestion. They've got so much coming in that they can't bring it onshore quickly enough," he said.

$80 swing in oil prices

It was China's purchases that helped prop up the battered oil market.

Just seven weeks after crashing to a low of negative $40 a barrel, US crude surged back to $40 a barrel. That $80 swing was driven by unprecedented supply cuts by OPEC and Russia, the lifting of health restrictions around the world and strong demand from China.

China, the world's second-largest economy, relies heavily on foreign crude to keep its economy humming. That's why it makes sense for the country to stockpile oil when global prices were at rock bottom.

China's oil imports soared 19% in May from the year before to a record high of 11.3 million barrels per day, according to S&P Global Platts. The country's shipments of foreign crude are expected to have topped that record in June.

A good-sized chunk of that oil originated in Latin America.

Brazil is the leading source of oil in China's floating storage, according to ClipperData. It takes about a month-and-a-half for crude to get shipped to China from Brazil. Much of the oil also comes from Iraq, Saudi Arabia and Nigeria.

'Buying like crazy'

Of course, other countries similarly took advantage of the oil crash to bolster their emergency stockpiles.

"If you're a big energy consumer, you'd be buying with two hands," said Ryan Fitzmaurice, energy strategist at Rabobank.

As oil prices were in free fall in March, the Trump administration promised to support US oil producers facing "potentially catastrophic losses" by purchasing 30 million barrels to bolster the Strategic Petroleum Reserve. The move marked a reversal from the government's previous plan to sell oil from the stockpile at what would have been weak prices.

But analysts said that China's stockpiling dwarfs what other nations have done in response to cheap prices. "China is the only country that has been buying like crazy. They went out and bought the dip," said ClipperData's Smith.

Fleeting arbitrage opportunity

Beyond the obvious energy security advantages, China's purchases also had enormous financial incentives.

That's because the oil markets this spring flipped into steep "contango" -- a phenomenon that occurs when investors are willing to pay far more for a commodity in the future than they would today. The situation creates an arbitrage opportunity for market players to store crude for a few months and then flip it at a later date for a tidy profit.

"Why sell it for -$40 when you can sell it a month later for $40?" Louise Dickson, oil markets analyst at Rystad Energy, wrote in an email to CNN Business.

Energy companies and investors in the spring started using ships not just for transporting oil but to store it.

That caused the rate to hire a very large crude carrier, or VLCC, which can hold 2 million barrels of crude, to more than double to $15 million for a journey from the US Gulf Coast to China in late April, according to Rystad.

"Now that the storage panic is lifted, no reason to book VLCC for storage," Dickson said.

Of course, the risk is that China's thirst for foreign oil will eventually be satisfied. Imports are already sitting at record highs. Floating storage is well above normal levels. And oil markets are no longer in contango.

ClipperData's Smith said that the traffic in crude bound for China has already begun to slow.

"Just as it helped support prices the past few months," he said, "it may do the opposite in the months ahead."

8. Fitch downgrades Alberta

[June 30,2020] On the heels of downgrading Canada's AAA sovereign rating last week, Fitch Rating is reducing Alberta's rating to AA- from AA, citing the effects of Covid-19 on the province's balance sheet.

Fitch said it downgraded Alberta due to "sharply higher provincial borrowing" during the current economic crisis, and the future recovery, which will raise its debt-to-GDP ratio.

The rating agency said that it expects Alberta to record a deficit of around $20 billion in fiscal 2021, up from the $6.8 billion deficit originally anticipated in the provincial budget

Fitch is also forecasting a 7.5% decline in nominal GDP for the province in 2020, followed by 4.7% growth in 2021, and 3.7% after that.

Alongside the downgrade, Fitch lowered its rating outlook on Alberta from stable to negative, citing the risk that added stressors could lead to a further deterioration in credit quality.

"The negative outlook is based on the potential that the risks identified in the rating case scenario are not sufficiently addressed by policy actions likely to be taken by the province through fiscal 2025," it said.

9. Canadian economy sees record plunge in April

[June 30,2020] Statistics Canada says the economy saw its largest monthly drop on record in April as it came to a near standstill due to the pandemic, but early indications point to a rebound in May as businesses began to reopen.

The agency said Tuesday gross domestic product fell 11.6% in April with non-essential businesses shut for the full month following a 7.5% decline in March.

However, Statistics Canada said its initial flash estimate points to growth of 3% in May. The estimate will be revised and finalized at the end of July.

Economists on average expect a drop of 13% for April, according to financial markets data firm Refinitiv.

Manufacturing was down 22.5% in April as many factories either shuttered or greatly reduced capacity in line with public health measures to slow the spread of Covid-19 — a move that hit the automotive sector hard as the output of motor vehicles plunged 97.7%.

Even sectors that had increases in March weren't spared in April like food manufacturing, which dropped 12.8% in April as outbreaks at meat processing plants forced them to shut down.

The accommodation and food services sector dropped 42.4% in April, as customers replaced eating out with staying in, hitting a sector that saw a 37.1% decline in March.

Output from bars and restaurants in particular plunged 40.8% as local and provincial states of emergency forced their closure, or limited operations to take-out and delivery.

Accommodation services fell 45.7%, Statistics Canada says, owing to restrictions on travel between provincial and international borders.

And then there was sports.

As Covid-19 iced the National Hockey League season and put the National Basketball Association, Major League Baseball and Major League Soccer on the sidelines, the arts and entertainment sector declined 25.6%, further affecting companies in the accommodation and food services sectors.

Down too was construction by 22.9%, concentrated largely in Ontario and Quebec, while a similar decline was noted in retail trade as brick-and-mortar stores stayed closed and consumers spent less while staying at home.

Poring through the data, Statistics Canada noted a jump in output of 17.3% from online shopping as households shifted their shopping habits.

The silver lining in the horrible April numbers may be that it marked the bottom of this short but extremely deep recession, CIBC chief economist Avery Shenfeld said.

In a note, he wrote that the flash estimate for May is roughly half of what was expected, but the rebound may be more robust in June with more economic reopenings taking place.

"But thereafter, repairing the rest of the March and April wreckage will be a slower process, as recent Covid-19 flare ups here and elsewhere are showing the hazards of moving too far ahead of the virus," he wrote.

"Markets were expecting the April news, and we can't tell if the flash estimate for May will be treated as a disappointment."

10. Canadians cutting spending, borrowing amid pandemic: survey

[June 29,2020] Most Canadians have cut back discretionary spending and are taking a more conservative approach to debt as they navigate the uncertainty from the Covid-19 pandemic, finds a survey conducted for CIBC.

Canadians are prioritizing emergency funds, and those who don't need to borrow money due to a loss of income are avoiding new debt.

More than one-fifth of Canadians (22%) said they've taken on more debt in the past 12 months. Interestingly, that total is lower than in December 2019 (28%).

However, more people are borrowing to cover day-to-day expenses (38%) and loss of income (28%), the survey found.

More than half of respondents (55%) said they need to get a better handle on their finances this year, and 63% said they've significantly cut their discretionary spending.

A report on Monday from RBC Economics found that consumer spending in June has nearly recovered to last year's totals. Online spending was way up and consumers cautiously returned to re-opened retail outlets, massage therapists and golf clubs, according to the analysis of RBC card transactions.

Maru/Blue conducted the online survey of 1,517 Maru Voice Canada panellists on June 8 and June 9 for CIBC. Online surveys can't be assigned a margin of error because they do not randomly sample the population. This survey was weighted for a more accurate representation.

Have a nice and fruitful week!