

ECONOMIC and FINANCIAL

# REVIEW

Office of the Vice-President  
Strategy, Risks and Performance

January 18, 2021



**AUTORITÉ  
DES MARCHÉS  
FINANCIERS**

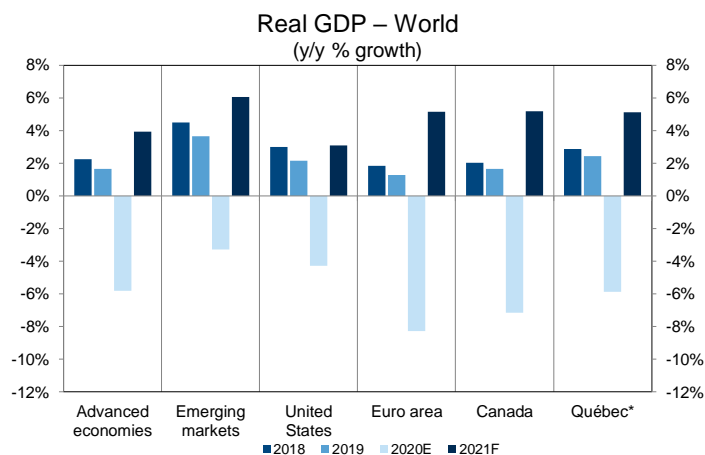
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## HIGHLIGHTS

- The global economy was traumatized by the COVID-19 pandemic in 2020. After the initial shock, there was a sharp recovery in the summer, but the second wave of the pandemic in the fall sapped much of its momentum. Global GDP finished the year down approximately 4%.
- In the United States, the economic contraction, while unprecedented, was less brutal than in most other developed nations because of less stringent public health measures and a first stimulus package that was among the most robust in the world.
- In Canada, the economy declined approximately 5.5% in 2020. The Bank of Canada plans to hold the policy interest rate at the effective lower bound until at least 2023 and continue its quantitative easing program until the economic recovery is well underway.
- In Québec, the decline in economic activity was especially pronounced during the first lockdown owing to the severity of public health measures. However, the pickup in activity since the summer recovered more than 80% of resulting job losses.
- Despite the impact of the public health crisis, global stock markets, pulled up mainly by technology stocks, ended the year in positive territory, with some U.S. indexes even reaching record levels.
- Bond yields dropped sharply in the wake of the pandemic. Central banks acted quickly at the outset of the crisis to implement ultra-accommodative monetary policies, which contributed to reduce yields to historic lows across the yield curve.



\* For 2021, average of forecasts by major Canadian financial institutions  
Sources: International Monetary Fund, Institut de la statistique du Québec and AMF

## REVIEW OF 2020

### January

- The WHO reported that a new coronavirus had been identified in China and confirmed its human-to-human transmission.
- The United States and China reached a truce in their tariff war by signing a “phase one” trade agreement that provided for a reduction in U.S. customs tariffs on Chinese products in exchange for the purchase by China of an additional US\$200 billion worth of U.S. goods and services.
- The United Kingdom left the European Union after nearly 50 years of membership.

### March

- The WHO declared a global COVID-19 pandemic as the virus spread from China, Iran and Italy to the rest of the world.
- The entire world went into lockdown, shuttering large parts of the global economy and leaving only essential services running.
- Governments, central banks and regulators announced multiple measures and rescue plans in an effort to support the economy and markets.
- Global stock markets plummeted, only to rebound in the subsequent months.

### April

- WTI crude oil prices slid into negative territory as demand collapsed and storage capacities quickly became saturated.

### June

- China passed a controversial national security law for Hong Kong that significantly restricted freedom of expression, leading Western nations to impose sanctions.

### July

- The Canada-United States-Mexico Agreement (CUSMA), further to amendments requested by the U.S. Congress, entered into force two years after the free trade agreement was signed.

### August

- The S&P 500 became the first major global stock index to erase all losses from the stock market rout in March.

### October

- In Québec, the number of COVID-19 cases passed the 100,000 mark.

### November

- Joe Biden won the U.S. presidential election, ending Donald Trump’s presidency after just one term.

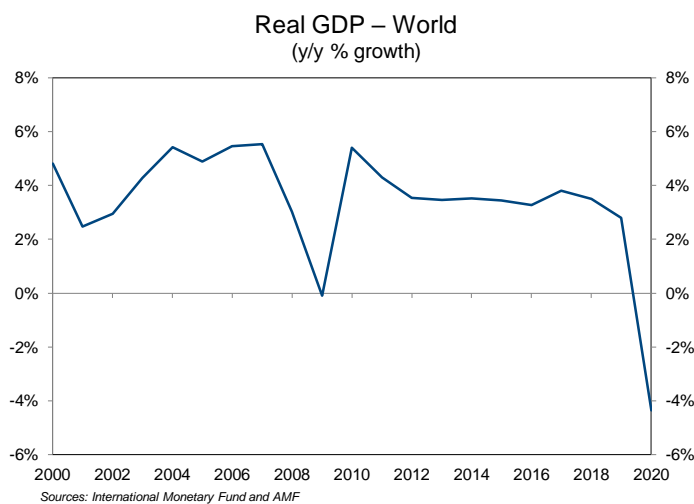
### December

- The United Kingdom, Canada and the United States were among the first countries to approve COVID-19 vaccines and begin vaccinating their citizens.
- The U.S. government and large corporations in the United States and several other countries were the target of a major cyberattack widely suspected to be the handiwork of Russia.
- The United Kingdom and the European Union finally reached a last-minute trade deal, which entered into force on January 1, 2021.

## ECONOMIC CONTEXT

### WORLD

The global economy was traumatized by the COVID-19 pandemic in 2020. The shock was brutal in the spring and the total economic lockdown plunged the world into a sudden, deep and synchronized recession. The pickup in activity in the summer was just as pronounced, but the second wave of the pandemic in the fall sapped much of its momentum. Global GDP finished 2020 down approximately 4%, with China, where the epidemic started, being one of the rare countries to record positive GDP growth.



Only large-scale, coordinated interventions by governments, central banks and regulators prevented an even worse scenario, and many of the measures that were implemented will be maintained for the foreseeable future.

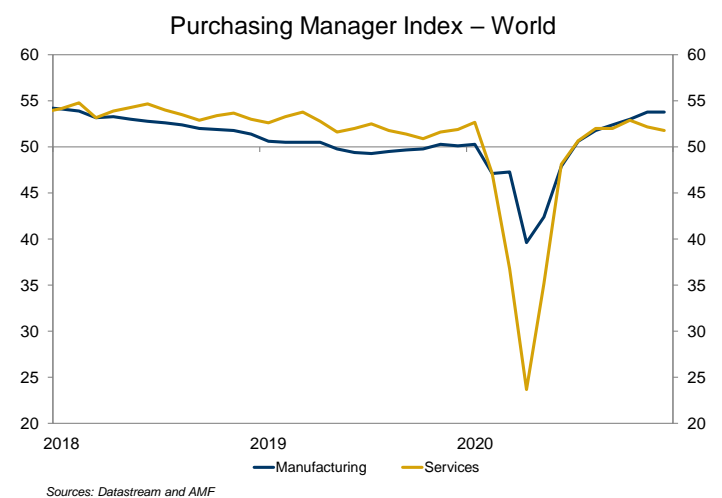
In fact, governments continue to borrow heavily to support their economies. At the end of the year, the United States and the European Union passed new stimulus packages totalling US\$900 billion and €750 billion, respectively.

Central banks are maintaining their ultra-accommodative monetary policies, using rock-bottom interest rates and large-scale asset purchase programs to preserve market liquidity and ensure very loose financial conditions. At its meeting in December,

the European Central Bank decided to make an additional €500 billion in asset purchases.

In the fall, the pandemic regained strength in North America and Europe. The return of lockdown measures, which hit the services industry particularly hard, put the breaks on the recovery that was underway.

Manufacturing purchasing managers indexes, however, remain in positive territory (above 50 percent) almost everywhere in the world, pointing to a continued recovery.



At year-end, approval of the first vaccines in North America and Europe provided a welcome shot of confidence, even though the vaccination period will stretch on for many months to come. The emergence of new, faster-spreading strains of the virus and the slow pace of vaccination rollouts have tempered hopes. The pandemic continues to worsen, leading many jurisdictions to impose even stricter lockdown measures. At the end of 2020, 85 million people had been infected by the virus and 1.8 million had died from it.

Things will not return to normal overnight. The global economy will bear the scars of the pandemic for months and years to come in the form of increased unemployment; higher household, corporate and government debt; production capacity that will need to be rebuilt; and supply chains that will have to be secured.

Pandemic woes are not the only cause for concern. So are tensions between China and the West. Relations between Washington and Beijing continued to deteriorate over the course of the year, despite the truce reached in the tariff war at the start of the year. The restrictions on civil liberties in Hong Kong, Chinese claims in the South China Sea, and the diversion of technology products for military purposes and spying are only some of the issues dividing the two major powers. These tensions are likely to persist under the new Biden administration.

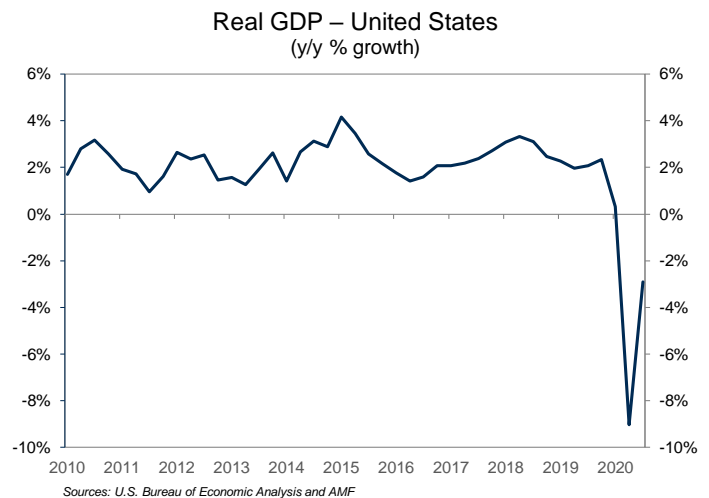
In Europe, the United Kingdom and the European Union finally struck a new post-Brexit trade agreement, narrowly avoiding a no-deal scenario. The agreement provides for the free movement of goods without tariffs or quotas (although it reintroduces border controls) and provides fair competition rules, particularly with respect to labour law, taxation and the environment.

Stock markets fared surprisingly well during the crisis, quickly recovering the losses incurred in March. From peak to trough, North American stock markets fell more than 30% before bouncing back on the strength of measures put in place to support the economy. During the fall, the S&P 500 and the Nasdaq even flew from record to record, driven by technology stocks.

Oil prices plummeted in the spring owing to collapsing demand, saturated storage capacity and a price war between Russia and Saudi Arabia. Although prices turned upward again owing to the gradual economic recovery and to output cuts, they ended the year below pre-pandemic levels.

## UNITED STATES

The U.S. economic contraction, while unprecedented, was less brutal than in most other developed countries. As a result of less stringent public health measures and a first stimulus package that was among the most robust in the world, U.S. GDP declined approximately 3.6% over the whole of 2020.



After a promising start during the summer, the economic recovery quickly lost steam during the fall. The slowdown was particularly pronounced in consumer spending, the main driver of the recovery in the summer. The sudden resurgence in COVID-19 cases rocked consumer confidence and dampened the recovery in employment.

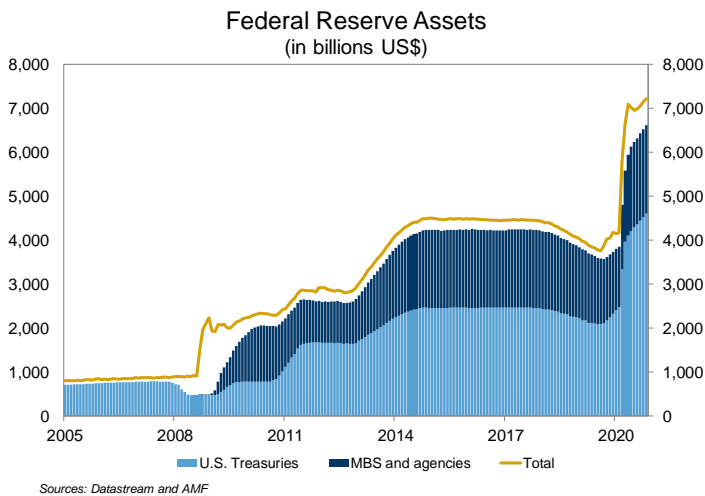
In fact, in the fall, the U.S. was hit by a third wave that was more aggressive than the first two, forcing many states to impose stricter lockdown rules. Moreover, a number of income support programs came to an end in the fall, and it took Congress several weeks to agree on the form that a new stimulus package would take. The new package, which is less generous than the first one, was passed just before the end of the year.

The recovery has been very uneven across the different sectors of the economy. While large parts of the economy remain depressed, some sectors are faring better. Manufacturing is making a strong comeback and housing market activity is at record levels.

To date, the labour market has only recouped 56% of the jobs lost in the spring. The steep decline in the jobless rate, from 14.7% to 6.7%, doesn't tell the whole story: a more extensive measurement of joblessness puts the rate at 12%. The number of first-time claims for unemployment benefits continues to be very high, with current numbers, at close to 780,000, remaining well above the record set in 1982.



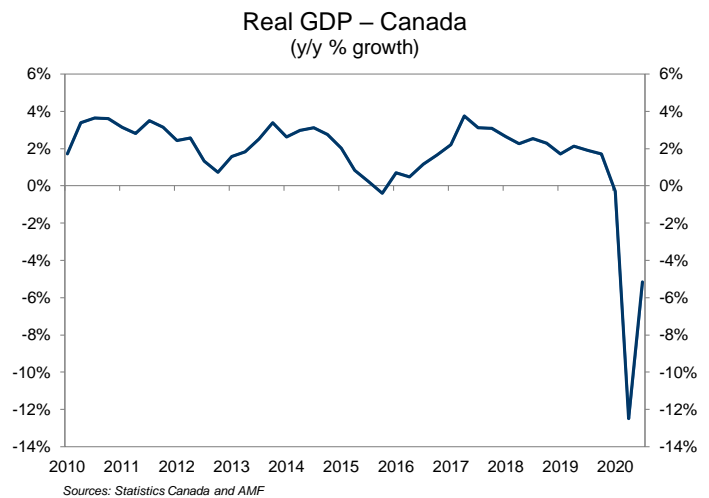
The U.S. Federal Reserve lowered its policy rate to the effective lower bound in March and plans to leave it there until 2023. It also took a number of quantitative easing steps to maintain very loose financial conditions for consumers, businesses, and the various levels of government. To date, the Fed’s efforts have more than doubled the size of its balance sheet. The Federal Reserve now holds more than a quarter of U.S. federal government debt and stands ready to do more if economic conditions deteriorate or the recovery lacks momentum.



The U.S. growth rate is expected to be about 3.25% in 2021, one of the lowest among the developed economies. The adoption of a new, more substantial stimulus package could help speed up the recovery. Like everywhere else, the economic outlook remains largely dependent on how the pandemic evolves over the short term.

## CANADA

The Canadian economy was hit hard by the pandemic, with GDP expected to finish the year down approximately 5.5%. However, generous household and business support programs, bolstered by an expansionary monetary policy, partly offset the impact of the pandemic and the lockdowns.



All components of demand, except residential investment, are expected to end the year down. Although domestic demand rebounded strongly in the third quarter, consumer spending and business investment are still below pre-pandemic levels.

In addition, the oil sector was pummeled by the collapse in oil prices in the spring. Challenges in the natural resources sector contributed to nearly one third of the decline in Canada’s GDP in 2020.

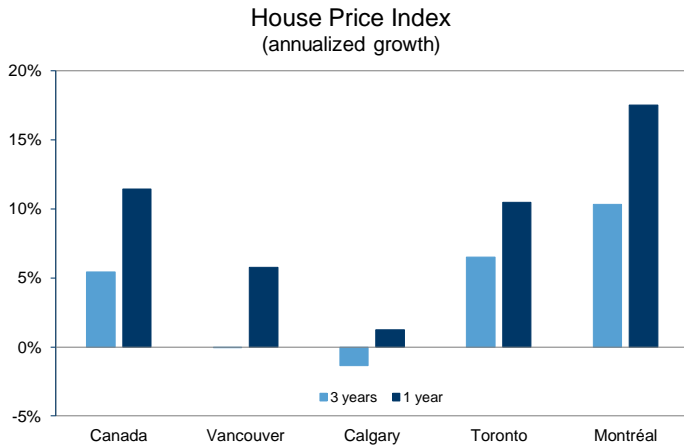
According to the Bank of Canada’s Business Outlook Survey indicator, business sentiment improved at the end of 2020, as did investment intentions. However, the effects of the pandemic on investment projects are still being felt in certain sectors, including restaurants, tourism and entertainment.

The federal government’s financial support programs increased household disposable income and the household savings rate in the first half of the year. However, indebtedness started to rise again in the third quarter. Consumer credit rebounded and mortgage debt reached an all-time high.

The lockdown did not spare the real estate market, but the backlog built up in the spring, partly as a result of the shutdown of Québec’s construction sector, was quickly cleared. The accumulated backlog, combined with low interest rates, lifted real estate activity to record levels during the summer months.

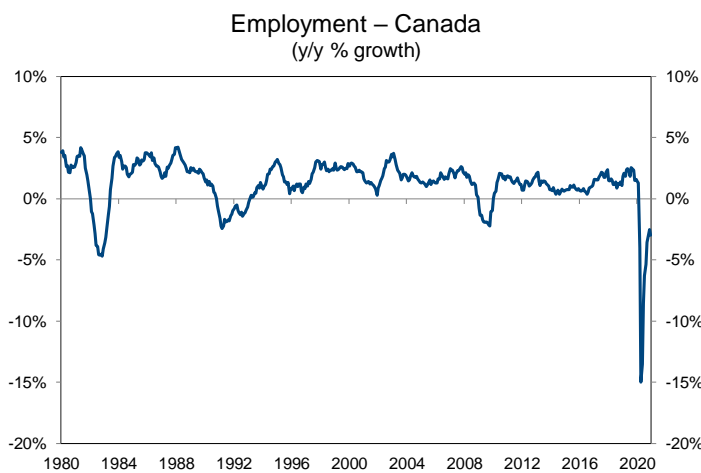
Activity also remained robust during the second half of the year, with sales reaching a new annual record in

2020. Because housing supply remains contained, prices are also rising at a sustained pace. The growth in prices is comparable to 2017 levels, although this time appreciation is being driven by Montréal, where prices are rising faster than in Toronto and Vancouver.



Sources: Canadian Real Estate Association and AMF

Although the labour market experienced a historic pullback in the spring, job recovery was swift and pronounced. However, the year ended with new job losses and, in December, 1.1 million workers continued to be affected by the public health crisis, with 636,000 people still unemployed and 488,000 working fewer hours than before the pandemic.



Sources: Statistics Canada and AMF

While the Canadian economy was dealt an unprecedented blow in the spring, some sectors continue to be more hard-hit. The second wave of restrictions and closures in the services sector (restaurants, arts and entertainment, etc.) in the fall of

2020 will have a more limited impact on economic growth, but many businesses could still be forced to close permanently.

Furthermore, if lower business investment persists over the medium term, it could reduce potential GDP growth, inflicting permanent damage on the Canadian economy.

It will likely take time for economic slack to be absorbed. As a result, the Bank of Canada plans to hold the policy interest rate at the effective lower bound until at least 2023. The Bank has also signaled that it will pursue its quantitative easing program until the economic recovery is well underway.

## QUÉBEC

The Québec economy, like economies elsewhere in the world, was plunged into a very severe contraction owing to the pandemic and lockdowns.

Preliminary estimates show that Québec’s GDP fell approximately 5% in 2020. Due to the imposition of strict public health measures in the province, the decline in activity was initially more pronounced in Québec than elsewhere in Canada.

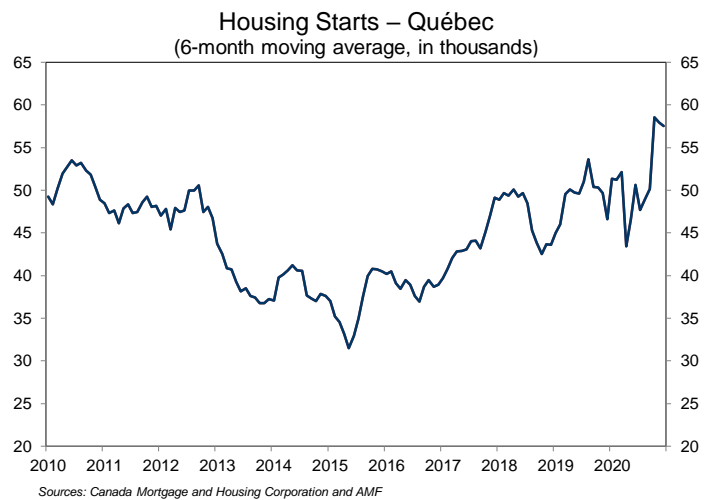
The pandemic and public health measures forced nearly 40% of Québec’s economy to shut down in the spring, resulting in a 14.3% decrease in GDP during the first half of 2020 compared with the end of 2019. Household consumption expenditure, business investment, and foreign trade were all adversely impacted.

Joint action by the Bank of Canada, the various levels of government and the financial regulators helped offset the most harmful effects of the lockdown on employment and production. Continued activity in sectors deemed essential and the wide-spread adoption of remote work also helped limit the damage.

The economic shutdown led to the loss of 820,500 jobs and a spike in the unemployment rate, which peaked at 17% in April 2020.



The economic recovery and gradual lifting of restrictions has resulted in the creation of 693,000 new jobs since May and the recovery of 84% of the jobs lost in the spring. The pace of job creation, however, has been losing momentum over the last few months, and the recovery in employment has been uneven across the different sectors. The restaurant, accommodation and entertainment industries and certain services to individuals were hit hard. Lockdown measures are still in place, delaying a return to normality. Québec’s unemployment rate nevertheless ended the year at 6.7%, the lowest of all the Canadian provinces.



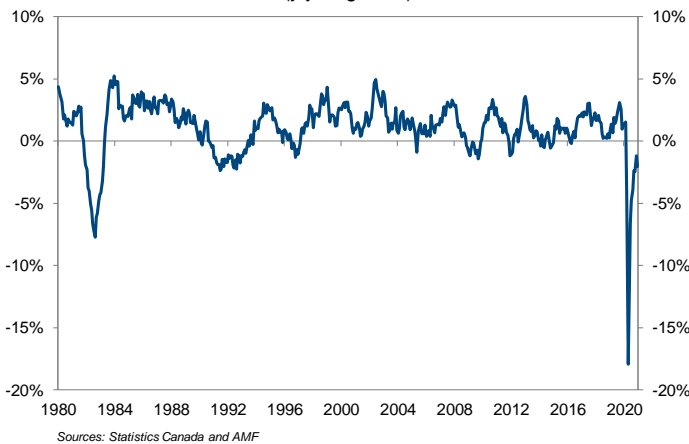
At the time of writing, the short-term economic outlook remains highly uncertain, despite approval of the vaccines and the start of the vaccination rollout.

The economic recovery will likely continue in 2021, with GDP expected to grow up to 5%. At that pace, the economy should return to pre-pandemic levels toward the end of 2021.

In the short term, however, the outlook is clouded by the increase in COVID-19 cases and the resulting impact on the number of hospitalizations and deaths. The tightening of lockdown measures at the start of the winter could result in a one-time backward step for the Québec economy, but nothing comparable to what was observed in the spring of 2020.

The arrival of vaccines is raising hopes of a gradual return to normality during 2021. However, the production, transportation and public distribution of the vaccines will pose a major logistical challenge for health authorities. As a result, it will be several more months before a critical mass of the population is vaccinated with a view to reaching herd immunity.

Employment – Québec (y/y % growth)

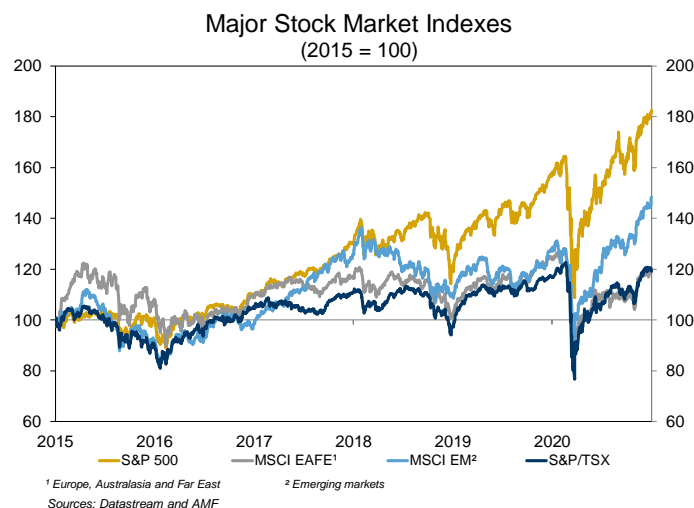


Residential construction was surprisingly strong, with 2020 becoming the most robust year for housing starts since 2010. In total, housing starts rose 19% in 2020, bolstered by very low mortgage rates and insufficient housing supply. As a result, property prices posted a record increase of nearly 20%. Lastly, after a forced pause in the spring, the resale market resumed activity.

## FINANCIAL MARKETS

### STOCK MARKETS

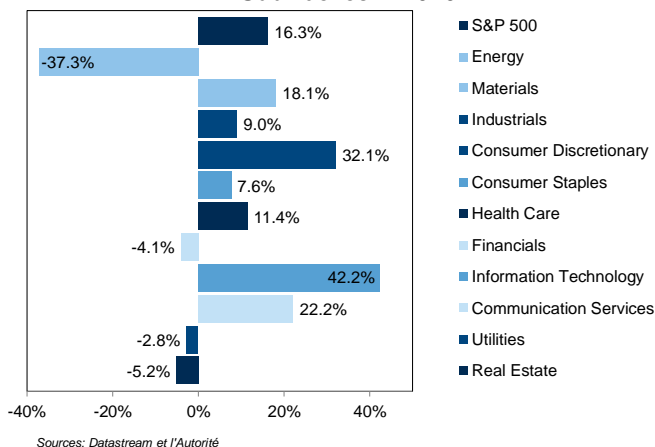
Despite the impacts of the COVID-19 pandemic, the global stock markets ended the year in positive territory. At the height of the crisis in March, the pandemic led to substantial declines on all stock markets. This bear market, however, was short-lived owing to the rapid, unprecedented response by governments and central banks.



U.S. stock markets led the way, generating impressive returns this year. The S&P 500 rebounded 67.9% from its low in March, ending the year up 16.3%.

In the first phase of the recovery, the strong performance of a few sectors that were less affected by and, in some cases, even benefitted from the pandemic enabled the indexes to regain much of the ground they had lost. In particular, technology companies quickly erased their losses and went on to post spectacular gains.

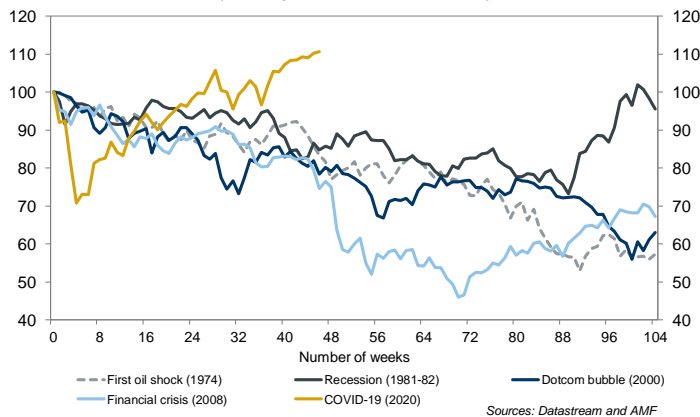
Performance of the Main S&P 500 Subindexes in 2020



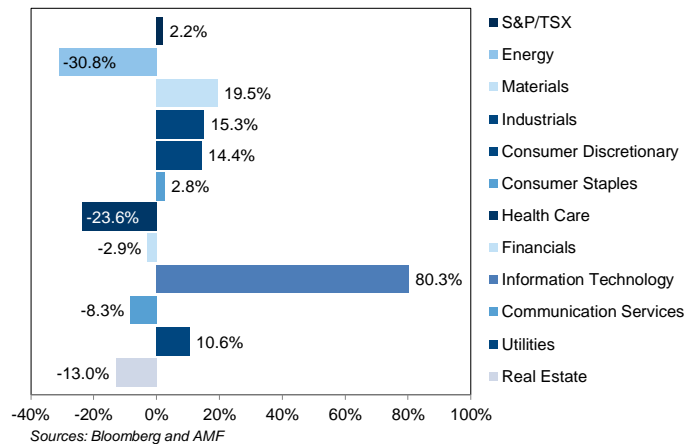
In the second phase, as economic conditions improved, more cyclical sectors such as financial services also helped drive up the indexes. Moreover, since November, the very promising results announced regarding COVID-19 vaccine effectiveness, combined with the outcome of the U.S. presidential election, have blown a gust of optimism through the markets, which has benefitted all sectors. The energy sector, however, remains significantly below beginning-of-year levels.

In the end, the COVID-19 bear market was characterized by a very rapid and steep decline in indexes, accompanied by almost unprecedented volatility, followed by an equally surprising rebound. In past decades, bear markets typically lasted for much longer periods. Moreover, total peak-to-trough declines in the indexes (-34% in the case of the S&P 500) were smaller than for many other bear markets, including the one in 2008.

Evolution of the S&P 500 during Major Bear Markets (100 = peak before correction)



Performance of the Main S&P/TSX Subindexes in 2020



The characteristics of this bear market partly reflect the nature of the economic shock and the actions taken by authorities. The shock, which was simultaneously sudden, intense and synchronized during the forced shutdown of many of the world’s major economies, was quickly followed by a rebound when public health measures were loosened. Furthermore, drawing on lessons learned during the 2008 crisis, governments and central banks acted with decisiveness and agility, which helped to quickly stabilize market conditions.

In Canada, the S&P/TSX followed a similar pattern, although the rebound was slightly less pronounced than for the S&P 500. The Toronto stock index, which fell approximately 37% during the bear market, ended the year up 2.2%. The TSX suffered from being heavily weighted in Energy and having a lower representation in Information Technology. However, Financials on the TSX performed relatively well despite a slight year-over-year decline, while Materials benefited from rising gold prices.

The Morningstar National Bank Québec Index, which tracks changes in the prices of Québec-based companies, posted a 1.5% annual return, slightly lower than the S&P/TSX. Nonetheless, Québec companies in Utilities, Materials, Information Technology and Consumer Discretionary performed very well.

As the stock markets have risen, so has the risk of overvaluation. At first glance, there appears to be a disconnect between the relatively high stock market valuations and the health of the economy, which, despite a significant rebound, remains far from full recovery. However, today’s across-the-board low interest rates are making the stock markets more appealing by increasing the present value of future corporate earnings.

Stock Market Valuations as of December 31, 2020

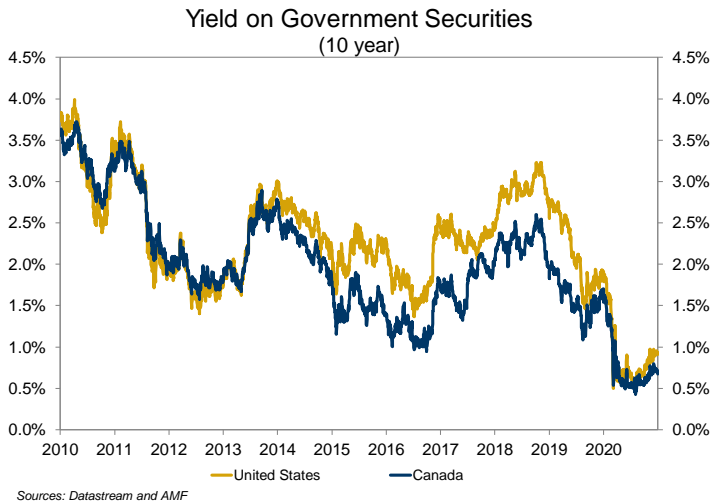
	Forward P/E ratio		P/E ratio		Dividend yield		Price to book	
	Actual	10 year average	Actual	10 year average	Actual	10 year average	Actual	10 year average
<b>World</b>	19.8	14.5	32.0	18.0	1.8	2.5	2.8	2.1
<b>United States</b>	23.2	16.1	30.4	18.9	1.5	2.0	4.3	2.8
<b>Canada</b>	16.1	14.6	23.2	17.9	3.0	2.9	1.9	1.9
<b>EAFE*</b>	17.4	13.6	43.8	18.6	2.4	3.3	1.8	1.6
<b>Emerging</b>	15.2	11.4	25.5	13.8	1.9	2.7	2.1	1.6

\* Europe, Australasia and Far East  
Sources: Bloomberg and AMF

Despite a sharp drop in corporate earnings in recent quarters, analysts’ consensus estimates suggest a return to normality as early as 2021. However, the risk of a new correction cannot be dismissed, particularly if the pandemic and the economic recovery take a negative turn.

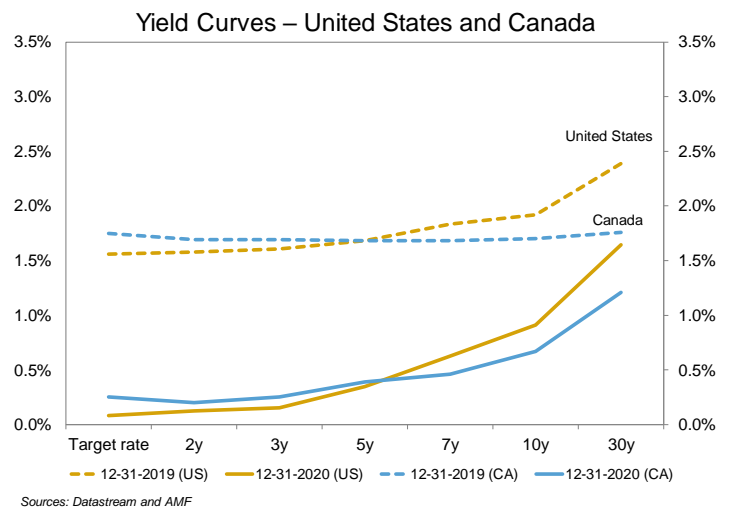
## BOND MARKETS

Bond yields dropped sharply in the wake of the pandemic and the resulting historically deep recession. Central banks acted quickly at the outset of the crisis to implement ultra-accommodative monetary policies, including large-scale bond purchase programs, which contributed to reduce yields to historic lows across the yield curve.



Long-term yields rose slightly in the second half of the year but remain nevertheless at extremely low levels, reflecting the outlook for a gradual economic recovery, moderate inflation and the continuation of current monetary policies. In fact, the major central banks are expected to hold their policy rates at the effective lower bound until 2023 and maintain their asset purchase programs for some time.

In the United States, U.S. government 10-year yields were at 0.9% at the end of the year, up from the summer low of 0.5%. The Fed plans to keep the target range for the federal funds rate at 0% to 0.25% until labour market conditions are consistent with maximum employment and inflation is on track to moderately exceed 2%. In addition, the Fed intends to continue its asset purchases for some time to ensure that these objectives are achieved. As may be recalled, the Fed's new mandate explicitly allows it to tolerate moderately higher inflation following periods of low inflation like we have today.



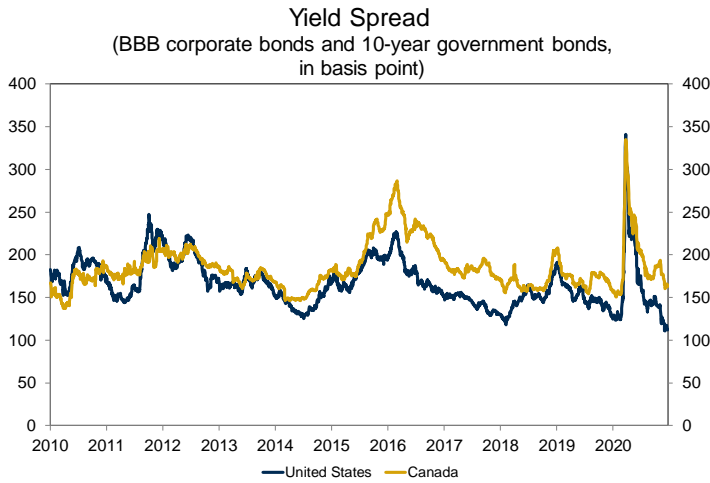
In Canada, yields on Government of Canada 10-year bonds ended the year at 0.7%, compared with 1.6% at the beginning of the year. The Bank of Canada will hold its policy interest rate at the effective lower bound until economic slack is absorbed and the inflation target of 2% is achieved for a sustained period, which it projects will happen in 2023. The Bank will also continue its quantitative easing program until the recovery is well underway.

In Europe, negative yields on government bonds are now the norm. In Germany, 10-year yields ended the year at -0.6%. Even countries with relatively weaker public finances, such as Greece, are borrowing at 0% or negative rates on certain maturities. Confronted with the pandemic's second wave, the European Central Bank had to enhance some of its programs, including the pandemic emergency purchase program, under which net purchases are expected to be conducted until at least the end of March 2022.

With the major central banks maintaining their ultra-accommodative policies, conditions are in place for a prolonged period of very low interest rates, especially since inflationary pressures are weak, reflecting persistent economic slack. However, there could be some resurgence of inflation if the global economy recovers more quickly than expected.

Yield spreads between corporate bonds and government bonds widened significantly at the start of the crisis. A number of bond markets, including in Canada, also experienced liquidity challenges. The

large-scale government interventions quickly reduced default risk concerns, while the targeted actions by central banks provided large injections of liquidity.



Yield spreads then quickly narrowed, ending the year near pre-pandemic levels. It should be noted that the impact of the pandemic on companies was smaller than what many investors had expected at the outset of the crisis. Although global corporate default rates rose significantly, they remain, for the time being, well below the levels reached in the aftermath of the 2008 crisis, for example.

How the pandemic plays out over the coming quarters will be critical. Although early results regarding vaccine effectiveness are encouraging, the pandemic's second wave could last for some time to come and further weaken corporate balance sheets, which, in many cases, have accumulated increasing levels of debt over the past year.

**Market Performance**

		Stock Markets									Last 12 months	
		Level	% change							Min.	Max.	
		2020-12-31	1 month	3 months	6 months	9 months	1 year	3 years <sup>2</sup>	5 years <sup>2</sup>			
MSCI All Country World Index		739	3.7	12.5	19.8	41.0	12.3	7.9	9.5	460	739	
MSCI EAFE <sup>1</sup>		1,174	2.4	11.1	11.8	25.1	-1.4	0.3	3.0	842	1,219	
MSCI Emerging Markets		71,693	5.9	15.7	24.7	44.6	16.6	5.6	10.0	44,713	71,693	
S&P 500		3,756	3.7	11.7	21.2	45.3	16.3	12.0	12.9	2,237	3,756	
S&P/TSX		17,433	1.4	8.1	12.4	30.3	2.2	2.5	6.0	11,228	17,944	
Morningstar National Bank Québec Index		330	4.1	15.5	24.2	38.8	1.5	4.6	8.2	201	337	
		Bond Markets									Last 12 months	
		Level	-1 month	-3 months	-6 months	-9 months	-1 year	-3 years	-5 years	Min.	Max.	
		2020-12-31										
Québec	10-year	1.3	1.3	1.3	1.3	1.9	2.3	2.6	2.4	1.2	2.3	
Ontario	10-year	1.3	1.4	1.3	1.3	1.9	2.3	2.6	2.4	1.2	2.3	
Canada	10-year	0.7	0.7	0.6	0.5	0.7	1.7	2.0	1.4	0.4	1.7	
United States	10-year	0.9	0.8	0.7	0.7	0.7	1.9	2.4	2.3	0.5	1.9	
United Kingdom	10-year	0.2	0.3	0.2	0.2	0.4	0.8	1.2	2.0	0.1	0.8	
Germany	10-year	-0.6	-0.6	-0.5	-0.5	-0.5	-0.2	0.4	0.6	-0.9	-0.2	
Canada	AA Corp. (10-year)	1.5	1.6	1.7	1.7	2.4	2.6	3.1	2.9	1.4	2.8	
	BBB Corp. (10-year)	2.3	2.4	2.4	2.6	3.8	3.3	3.8	3.9	2.3	4.2	
	BBB - 10-year Gov. spread	1.6	1.7	1.9	2.1	3.1	1.6	1.7	2.5	1.5	3.3	
United States	AA Corp. (10-year)	1.4	1.5	1.5	1.6	2.2	2.5	3.1	3.2	1.2	3.3	
	BBB Corp. (10-year)	2.0	2.0	2.2	2.4	3.5	3.2	3.7	4.2	1.9	4.2	
	BBB - 10-year Gov. spread	1.1	1.2	1.5	1.7	2.8	1.3	1.3	2.0	1.1	3.4	

<sup>1</sup>Europe, Australasia and Far East    <sup>2</sup>Annualized returns  
Sources: Datastream, Bloomberg and AMF

## RISKS AND ISSUES TO MONITOR IN 2021

- With the second wave of infections accelerating around the world, hospital systems nearing breaking point, and vaccination rollouts off to a slow start in many countries, the global economy will continue to experience a high degree of uncertainty over the short term.
- The economy will continue to depend on how the pandemic unfolds and what actions are taken to contain the spread of the virus and its effects on economic activity and employment. The recovery is already slower than initially anticipated, and the situation could continue to worsen before things return to normal. There is an increasing consensus that the pandemic will have lasting long-term effects on potential GDP.
- In the United States, Joe Biden is taking over the reins of government in an extremely polarized political environment, reflected in the storming of the Capitol in early January 2021. The new president will have his work cut out for him to rally U.S. citizens amid an economic and public health crisis. His policies will also mark a trend reversal on the international stage in favour of multilateralism.
- In Canada, the federal government's household and business support programs, while they have helped offset the impacts of the crisis, have also ballooned the public deficit, which will total between \$380 billion and \$400 billion in 2021. The debt-to-GDP ratio could increase to a record 52.6% next year, a level that remains manageable given current low interest rates. However, a rise in interest rates or weaker-than-expected medium-term economic growth would have a significant impact on public finances. It should be recalled that Fitch Ratings downgraded Canada's credit rating in June.
- Real estate market activity in Canada has been very strong despite the pandemic, bolstered in part by low interest rates, with the Bank of Canada having cut its policy rate to the effective lower bound in March. Sales reached an all-time high in 2020, and price increases are comparable to 2017 levels. Although the wave of payment defaults following the end of the payment deferrals granted by financial institutions has likely been averted, such a level of activity appears difficult to sustain for the long term. Price and sales trends will need to be monitored during the coming quarters.
- The stock markets rebounded in convincing fashion following the COVID-19 shock. For many markets, a significant portion of the rise in indexes reflects an increase in valuation levels. In particular, the price/earnings ratio for the S&P 500 is well above its historical average. The valuation levels can be explained, in part, by the low interest rates. Nevertheless, any shock that adversely impacts the economy and corporate earnings could trigger a major stock market correction.
- The low interest rates are a reflection of central bank policies, excess production capacity and moderate inflation. These factors will, in all likelihood, persist over the coming quarters. However, a faster-than-expected economic recovery could create upward pressure on inflation and interest rates. If monetary policy is retightened too quickly, it could destabilize the stock markets.
- In some cases, low rates are incentivizing risk-taking by market participants, making markets more vulnerable to a potential shock. On the bond markets, for example, yield spreads between corporate bonds and government bonds are relatively tight.
- Corporate indebtedness has risen significantly during the past decade in Canada and elsewhere around the world, including in the United States. The quality of corporate debt has also tended to deteriorate. As a result, there has been a significant increase in the issuance of bonds rated BBB or lower as well as a widespread easing of borrowing terms. The COVID-19 pandemic has amplified these trends and increased corporate refinancing risk and, ultimately, corporate payment default risk.



- This past year has shown the extent to which the physical risks posed by climate change (fires, hurricanes, floods, etc.) appear to be increasing and impacting the global economy. Various regulations affecting the development of taxation tools, enhanced disclosure of financial risks related to climate change, and incentives to advance the transition to a more sustainable economy are expected at the international level in 2021. The new U.S. administration, which has made strong commitments in these areas, will reinforce this trend.
- The growing number of ESG financial products being offered (i.e. that take into account environmental, social and governance factors) is raising issues. These products invest in the transition to an economy that is less carbon-intensive and more environmentally friendly. However, there are no standardized investment criteria for this new asset class, which could result in a misunderstanding of how the investment criteria are applied and impair financial performance comparability among products.
- Self-directed, on-line securities brokerage services, also called “discount brokerages,” have been among the financial industry’s winners amid the pandemic. Nearly 500,000 new brokerage accounts were reportedly opened in Canada at the end of the first quarter of 2020 alone. Account openings were bolstered by the lockdown, the upswing in financial markets starting in March 2020 and the upsurge in the household savings rate.
- The pandemic has hastened the digital transformation of the financial industry. This transformation will continue in 2021. Fintechs, the Big Techs (GAFAM) and more traditional players seeking to remain competitive are proposing increasingly personalized financial services. There will also be strong trend toward establishing digital identities that can ensure a high level of trust among all stakeholders and protect consumers. Areas of focus include efforts to develop and establish an open banking system, the emergence of decentralized finance (DeFi) and the significant advances in testing central bank digital currency solutions.
- Cybersecurity and the protection of personal data are very important issues for the financial sector. A number of recent incidents have underscored the importance of continually enhancing the financial system’s ability to address these issues. Furthermore, the COVID-19 pandemic has deepened certain trends such as remote work and the digital shift. In some cases, these changes are creating opportunities for cyber criminals and making the financial sector even more dependent on the operational effectiveness of computer systems. Over the longer term, we can expect issues related to cybersecurity and personal data protection to take on ever greater importance.
- In the United States, given the Biden administration’s priorities related to the economic and public health crisis and the fairly modest financial regulatory changes introduced under the Trump administration, regulatory reform is not expected to be a major area of interest in the coming year. However, the Senate, now controlled by the Democrats, will appoint people who reflect the party’s position to head the Treasury Department and financial regulatory agencies (including the SEC, CFTC and OCC).
- In Canada, the Canadian Securities Administrators (CSA) continues to seek to reduce regulatory burden while maintaining the required protections for investors. To achieve this goal, the CSA undertook ten initiatives aimed at addressing regulatory burden for a broad range of market participants, including public and exempt issuers, investment funds and registrants, to ensure requirements continue to be appropriate, necessary and relevant. As certain trends have been amplified by the pandemic, we could also see regulatory relief with respect to new capital raising prospectus exemptions.

## NOTE

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