

Canada August 3, 2019 6:00 am

# Can you recession-proof yourself? Experts say there are ways to avoid the worst



By Jessica Vomiero

National Online Journalist Global News

## **WATCH: For the first time in 10 years, the U.S. Federal Reserve is expected to cut interest rates.**

With a number of financial indicators suggesting a recession is on the way, you may be wondering if it's possible to weather the coming storm.

Some of these indicators include an inverted yield curve (when short-term investments yield greater returns than long-term investments), the Federal Reserve cutting interest rates this week for the first time in a decade and soft markets (when an industry has more sellers than buyers) emerging in manufacturing, consumer spending and housing.

## **WATCH: U.K. minister says country is 'turbo-charging' preparations for no-deal Brexit**

While some economists have predicted a recession is likely due for some time during 2020-21, many told Global News that savvy consumers can come out on the other side relatively unscathed.

Here are some strategies for protecting your finances ahead of a possible dip in the market:

### **Get rid of credit card debt**

Just before a recession is the best time to get rid of credit card debt, explained economist Campbell Harvey a Canadian economist with Duke University.

"When you don't pay that credit card there's an interest amounting, so I usually recommend that first thing. You've got to get rid of that right now," Harvey said.

That might mean giving up some spending to work off outstanding credit debt, but he said outstanding debt is going to be much more expensive in a recession when money is tight.

"You don't have the money to pay, you're going to spiral and it's going to impact your credit."

## **READ MORE: Model that predicted 2008 financial crisis suggests another recession is coming: expert**

Andrew Pyle, a portfolio manager and branch manager with Scotia Wealth Management, seconded this statement, adding that the 2008 U.S. financial crisis is a good example of what happens when high-debt households suddenly find themselves unable to support that debt.

“Avoid being in too much debt, where your ability to service that debt is dependent on keeping your job,” he explained.

“The U.S. experience in the financial crisis demonstrated what happens when households have too much debt and then, either because of higher interest rates or loss of income, can no longer support that debt, resulting in getting rid of their homes in the worst-case scenario.”

As of December, 2018, the overall debt-to-income ratio for Canadians was nearing a record high. Statistics Canada said household credit market debt as a proportion of household income was 177.5 per cent in the third quarter on a seasonally-adjusted basis.

In other words, Canadians owed nearly \$1.78 in credit market debt, which includes consumer credit and mortgage and non-mortgage loans, for every dollar of household disposable income in the third quarter.

While many financial services firms advise maintaining a debt-to-income ratio of about 36 per cent or lower, Eric Kam, an economist with Ryerson University, states that the best way to maintain a low level of debt is to spend less than what you earn.

“It’s not about how much you earn, it’s how much you spend. If you’re spending more than you’re earning you’re going to go into debt,” Kam explained.

## **Build up your savings**

Pyle also went on to say that maintaining emergency funds is a good way to protect yourself if a recession is suspected to be around the corner. He adds, however, that habitual savers will be the most prepared for a recession.

“Maintaining an emergency or rainy day cash reserve is always prudent regardless of whether we think we are going into recession,” he said. “For those households that depend on two incomes, this is especially important in case one person loses a job in the recession.”

Pyle added that while saving money is ideal, your vulnerability during a recession has much to do with your circumstances in life: whether you’re financially secure, retired, a recent grad with student loans, etc.

## **READ MORE: With fixed rates below variable ones, mortgage market is in the Upside Down**

“Those with more money in reserve and less debt are going to be less exposed than those with high debt levels and dependent on employment income,” Pyle said.

Talan Iscan, an economist with Dalhousie University, notes that it’s important to distinguish between people living paycheck to paycheck and those with excess wealth.

“One thing you can do to prepare yourself for a worst-case scenario is put aside some funds for a rainy day, and this is not a viable option for a lot of people because they already don’t have a lot of room to save,” he explained.

As a rule of thumb, Kam states that most financial experts advise keeping an emergency fund worth three months income. For example, according to the RBC Emergency Fund calculator, someone earning

CAD\$50,000 per year should have \$13, 539 put away in case of emergencies (income taxes not considered).

However, he adds that these numbers always vary based on an individual's personal income and risk appetite.

## **Hold off on big loans and major investments**

People without the budget for discretionary spending should also think twice about major loans or investments and consider holding off on changing jobs.

If you suspect the market might take a turn in the near future, it may not be the time to take out a new mortgage or finance a new car, Iscan explained.

"When it comes to mortgages and car loans... People should think twice about these things," he said.

Iscan notes that in addition to avoiding taking on significant debt, it may also be wise to reconsider any large purchases, such as vacations — or at least put them off until the worst has passed.

## **WATCH: Canada's premiers focus on trade, economy as they meet in Saskatoon**

"If there is an imminent danger, you should look at your expenditure and say, 'Do I really need to take this long weekend vacation to Florida?'"

Investors should also be mindful, he explained, that a mass scale-back in major purchases during financial hard times tends to impact particular industries more than others.

For example, trade, hospitality and tourism, and real estate are particularly susceptible to economic woes, whereas consistent consumer needs such as education and health care tend to be more resilient.

## **Don't change jobs just yet**

Harvey also advises that before a recession is a bad time to be looking for work.

"This is not a particularly good time to quit the job that you don't like and start looking for another job," Harvey explained.

In addition, individuals will want to make sure they continue to perform in their current roles, or they may be the first to go when a recession does hit, he said.

## **READ MORE: Canada's GDP grows 0.3% in January, beating expectations**

"Often what happens is people just don't put the same amount of effort into the job that they don't like while they're looking for another job, or it gets out that they're looking for another job, and then when the recession comes, they're the first one axed," Harvey said.

Even those who are able to find another job may find themselves with the least seniority at their new job. If the economy isn't doing well, Harvey warns that people in this position may also be first to be let go.

## **Could all this recession talk... lead to a recession?**

Pyle also noted that recession paranoia could be a self-fulfilling prophecy.

“We saw this somewhat towards the end of last year when individuals believed we were on the verge of recession. Stock markets fell, which contributed to that anxiety, and consumer confidence fell,” he said.

He added that if businesses believe a recession is coming, they’re more inclined to cut staffing levels, which exacerbates minor economic slowdowns.

“Consumption represents the largest part of both the Canadian and U.S. economies — over two-thirds of overall spending — so what happens to the consumer is going to have a pronounced impact on the economy,” Pyle said.

### **WATCH: G20 leaders highlight global trade concerns during first day of summit**

Harvey counters that it’s better to be prepared, regardless of whether this behaviour increases the likelihood that a recession will occur.

“To me, a better strategy is to take that information and protect yourself.”

### **Get daily local headlines and alerts**

© 2019 Global News, a division of Corus Entertainment Inc.