Weekly Updates Issue # 579

1. Weekly Markets Changes
2. Big banks' Q3 earnings defy sluggish economy
3. Yellen cautious, but says case for rate hike stronger
4. Ottawa runs $1-billion deficit in first quarter
5. Royal Bank 'closely monitoring' housing market
6. Fort McMurray wildfire adds $500M to Alberta's projected deficit
7. Why the loonie is still flying high despite the economic storm clouds
8. Average price for GTA low-rise home exceeds $900,000

1. Weekly Markets Changes

[August 26, 2016]

S&P TSX	S&P 500	Dow Jones	NASDAQ	CAD/USD	Gold	WTI Crude
14,639.88 -47.58 -0.32%	2,169.04 -14.83 -0.68%	18,359.40 -157.2 -0.85%	5,218.92 -19.46 -0.37%	$0.7693 -0.75¢ -0.97%	$1,324.00 -21.80 -1.62%	$47.29 -1.64 -3.35%

2. Big banks' Q3 earnings defy sluggish economy

[August 25, 2016] Panic about how the oil price shock could affect the banks' bottom lines has subsided, as several of the country's largest financial institutions reported better-than-expected Q3 results.

The earnings come in spite of headwinds such as rock-bottom interest rates, slowing loan growth and the sluggish economy, which have been dampening the outlook for the sector in recent quarters.

"We're very pleased with our performances this quarter, which was achieved against a backdrop of an economic environment that remains challenging and the volatile market conditions coming out of the Brexit vote," CIBC CEO Victor Dodig says on a conference call Thursday to discuss the bank's results.

"Although we can't control the economy or the interest-rate environment, what our team at CIBC can do is control our strategy to remain profitable and to continue to grow under these conditions," he says.

CIBC reported that its quarterly profit climbed nearly 50% from a year ago to $1.44 billion, although much of the jump came from the sale of its minority stake in American Century Investments. Without the gains from the sale, the bank says its profit was up 8% to $1.07 billion from $990 million.

Over the last few quarters, Canadian banks have been setting aside more money for bad loans to companies in the oilpatch, but that trend has now begun to reverse, with some banks reporting lower provisions for credit losses.

Barclays analyst John Aiken says CIBC's energy-related loan loss provisions were "essentially nil," which contributed to the better-than-expected earnings results.
"The material decline in provisions for credit losses was driven by the fact that essentially none were taken in the quarter for energy loans," Aiken says in a note to clients.
Meanwhile, TD Bank saw its Q3 profit rise 4% from a year ago to $2.36 billion, partly thanks to strong earnings from its U.S. retail banking operations.
That's compared to the $2.27 billion the bank earned during the same quarter last year.
Provisions for credit losses were $556 million, down from $584 million in the previous quarter.
"Credit was reasonably benign, with provisions for energy easing, similar to most of the banks so far this quarter and no discernible deterioration in consumer credit," Aiken says.
Earlier this week, the Bank of Montreal reported that its Q3 profit grew 4% to $1.25 billion, while Royal Bank grew its profit by 17% from a year ago to $2.895 billion — partly due to the sale of an insurance business.
Another theme that has emerged during this week's conference calls has been the real estate market and what impact a correction in housing prices could have on the banks' portfolios of mortgage loans.
RBC CEO David McKay said Wednesday that the lender is "closely monitoring" the Toronto and Vancouver housing markets, where prices have been soaring at what some consider an unsustainable pace.
On Thursday, CIBC chief risk officer Laura Dottori-Attanasio told analysts that if house prices fall by 30% and unemployment climbs to 11%, CIBC's losses would be less than $100 million.
That's according to stress tests, which banks routinely perform to gauge how their loan books would perform under various economic scenarios.
The earnings season will wrap up next week, with Scotiabank reporting its results on Tuesday and National Bank slated to follow on Wednesday.

3. Yellen cautious, but says case for rate hike stronger

[August 26, 2016] The strengthening U.S. economy is near the Fed's "statutory goals of maximum employment and price stability," said Fed Chair Janet Yellen in her Jackson Hole, Wyoming speech this morning.
The line that most excited markets was Yellen's hint at an upcoming rate rise: "In light of the continued solid performance of the labor market and our

outlook for economic activity and inflation, I believe the case for an increase in the federal funds rate has strengthened in recent months," she notes.
On the back of that statement, reports Associated Press, some economists now think conditions are ripe for the Fed to act at its next policy meeting in September. Still, AP adds, other economists say December remains a more likely time for a resumption of rate increases.
That's because the Fed may need to further prepare investors. According to data from the CME Group on Friday morning, the market's forecast of a rate hike in September was fluctuating between about 18% and 24% based on immediate reaction to Yellen's speech—that was within yesterday's reading of a 21% chance.
Yellen's tone was cautious as she outlined good and bad economic news. In her speech, Yellen says: "U.S. economic activity continues to expand, led by solid growth in household spending. But business investment remains soft, and subdued foreign demand and the appreciation of the dollar since mid-2014 continue to restrain exports."
She adds that, "while economic growth has not been rapid, it has been sufficient to generate further improvement in the labor market. Smoothing through the monthly ups and downs, job gains averaged 190,000 per month over the past three months. Although the unemployment rate has remained fairly steady this year (near 5%), broader measures of labor utilization have improved."
But, Yellen notes, inflation has continued to run below the FOMC's objective of 2%, "reflecting in part the transitory effects of earlier declines in energy and import prices."

The future of monetary policy

The focus of Yellen's speech was on the current state of monetary policy and on how it could be improved. She wonders "whether our existing tools are adequate to respond to future economic downturns […] One lesson from the crisis is that our pre-crisis toolkit was inadequate to address the range of economic circumstances that we faced."
For example, she finds the Federal Reserve's monetary policy toolkit was relatively simple prior to the financial crisis, which revealed shortcomings. "The first [issue] was an inability to control the federal funds rate once reserves were no longer relatively scarce. Starting in late 2007, faced with acute financial market distress, the Federal Reserve created programs to keep credit flowing to households and businesses. The loans extended under those programs helped stabilize the financial system. But the additional reserves created by these programs, if left unchecked, would have pushed down the federal funds rate, driving it well below the FOMC's target."

To prevent this, the Federal Reserve tried to "sterilize the effect of its liquidity and credit operations on reserves," she adds. But, "by the fall of 2008, the reserve effects of our liquidity and credit programs threatened to become too large to sterilize via asset sales and other existing tools. [Thus], the quantity of reserves increased to a point that the Federal Reserve had difficulty maintaining effective control over the federal funds rate."

Looking forward, says Yellen, "we will likely need to retain many of the monetary policy tools that were developed to promote recovery from the crisis. In addition, policymakers inside and outside the Fed may wish at some point to consider additional options to secure a strong and resilient economy."

Yellen expects forward guidance and asset purchases will remain key components of the Fed's policy toolkit. But, she says, "These tools are not a panacea," which is why future policymakers may explore the possibility of purchasing a broader range of assets. Further, says Yellen, "some observers have suggested raising the FOMC's 2% inflation objective or implementing policy through alternative monetary policy frameworks, such as price-level or nominal GDP targeting."

Yellen notes the FOMC isn't actively considering these additional tools and policy frameworks, but they're being researched.

Additional news

In advance of Yellen's speech today, Fed members Esther George and Stanley Fischer (and eight other Fed officials) met with about 120 activists from the Campaign for Popular Democracy's Fed Up coalition, reports AP. The group of policy activists, labour unions and community groups has been lobbying the Fed to keep rates low to allow the economy to strengthen enough to benefit more Americans.

The coalition also wants the Fed and Congress to consider changes in the makeup of the boards of directors of the 12 regional banks to promote diversity.

4. Ottawa runs $1-billion deficit in first quarter

[August 26, 2016] The federal government ran a deficit of $1 billion for the first quarter of its fiscal year, down from a surplus of $5 billion in the same period last year. But that's "broadly consistent" with projections in the 2016-2017 budget, the Finance Department said Friday.

"The financial results for the first three months of the fiscal year provide limited information with respect to the outlook for the year as a whole," the department said in its fiscal monitor report.

“This is because the timing of revenues and expenses can vary from year to year and because the results do not yet reflect several significant government initiatives, such as the introduction of the Canada child benefit.”

In the spring budget, the Liberal government projected a $29.4-billion deficit for the 2016-2017 fiscal year, which included billions in spending. Those expenditures included the Canada child benefit, which began going out to families in July.

Government revenues fell $1.5 billion or 2.1% to $71.8 billion in the first quarter of the fiscal year, while program spending increased $5.1 billion or 8.3% to $66.4 billion. Public debt charges totaled nearly $6.4 billion, down from $7 billion, due largely to a lower average interest rate.

For June, the federal government ran a deficit of $1.1 billion as revenue fell and spending increased. The shortfall compared with a surplus of $1.1 billion in the same month last year.

Revenue fell $500 million or 2.2% in June due to lower corporate income tax revenue, non-resident income tax and excise taxes and duties.

Program spending grew by $1.6 billion that month, an increase of 7.5%, due to growth in major transfers to other levels of government and direct program expenses, though that was partially offset by a drop in transfers to people such as social benefit payments.

Public debt charges increased by $100 million or 3.1%, mainly due to higher consumer price index adjustments on real return bonds.

5. Royal Bank ‘closely monitoring’ housing market

[August 24, 2016] Royal Bank CEO David McKay says the lender is “closely monitoring” the real estate markets in Vancouver and Toronto, where home prices have been climbing at a breakneck pace.

“The short supply of single-family homes in both cities — coupled with strong demand fueled by household formation, including net immigration — has driven strong price appreciation,” McKay said during a conference call to discuss the bank’s third-quarter results.

“We have prudent underwriting practices in place and the necessary technology to closely monitor these markets and quickly react as situations may materialize.”

McKay added that he supports Ottawa’s plan to form a working group to study the housing market and develop recommendations to mitigate some of the risks stemming from the combination of soaring house prices and record levels of consumer debt.

Executives at RBC, which reported $2.895 billion of net income in the third quarter, were peppered with questions about the bank's residential mortgage portfolio during Wednesday's conference call.
Analysts wanted to know what contingency plans the bank has in place in the event of a downturn in house prices.
RBC's chief risk officer Mark Hughes touted the bank's "diligent" process for verifying the incomes of borrowers and noted that the bank doesn't participate in the second mortgage market or offer subprime mortgage loans.
Hughes also highlighted the fact that 48% of the loan portfolio is insured, up from 46% last year.
The bank purchased additional portfolio insurance this quarter, Hughes added.
"Overall, we remain comfortable with our exposure to the Canadian housing market," he said.
"Our clients' credit profiles are strong and have remained stable."
Edward Jones analyst Jim Shanahan said that while having credit-worthy customers is important, it doesn't insulate the bank from potential losses in the event of a correction or a crash.
"If there's a substantial decline in home prices in Canada, it's unlikely that any Canadian bank wouldn't feel some pain, whether they were selecting high-quality customers or not," he said.
According to Shanahan, slightly more than half of RBC's $531-billion loan book is comprised of Canadian residential real estate loans such as mortgages and home equity lines of credit.
"It's the biggest pocket of risk in the loan book," he said.
"There's some concern from time to time about oil and gas loans, but that's only a $7-billion portfolio out of $531 billion. That's really small."
Shanahan noted that for now, there's no data to suggest that a correction is coming — but it's certainly something worth keeping an eye on.
Housing affordability has become a concern in Toronto and Vancouver. According to data from RBC, home-ownership costs for a single detached house in Toronto were 71.4% of the median household income, while in Vancouver costs were at 109% of the median income.

6. Fort McMurray wildfire adds $500M to Alberta's projected deficit

[August 24, 2016] The devastating Fort McMurray wildfire is expected to torch Alberta's bottom line by about $500 million this year.

Finance Minister Joe Ceci says he has had to revise the projected deficit upward in his first-quarter fiscal update to almost $11 billion from $10.4 billion.

“I don’t need to tell my fellow Albertans that as a result of the oil-price shock, the economic headwinds facing Alberta remain strong. Albertans see that every day. Many are suffering significant hardship,” Ceci said Tuesday at a news conference where he released the latest numbers.

“This year those headwinds are blowing even harder as a result of the Wood Buffalo wildfire.”

Regardless, Ceci said, the province will stick to its plan of avoiding deep cuts to the civil service, while continuing to accumulate debt to pay for roads, infrastructure, health and education.

“We’re not going to make knee-jerk cuts. We’re not going to make things worse for Albertans,” he said.

The May fire in northern Alberta forced more than 80,000 people to flee for a month and destroyed 2,400 homes and buildings in the oilsands hub city.

Ceci said the province paid out $647 million in disaster relief, a figure reduced to $195 million after federal aid transfers.

On top of that, the province estimates it lost another $300 million in revenue, because the fire severely curtailed oilsands and forestry activity in the area. An estimated 40-million barrels worth of production was lost.

The government forecasts Alberta’s overall oil production for the 2016-17 fiscal year will be down about 4% due to the shutdown.

Rebuilding parts of Fort McMurray is expected to boost provincial growth in the years to come, but business losses are expected to cancel out any such stimulus this year.

Insurable losses from the wildfires are pegged at $3.6 billion.

The Fort McMurray numbers come on top of gloomy forecasts as low oil prices continue to depress Alberta’s economy, although a modest recovery is predicted for 2017.

Alberta’s real GDP, the benchmark figure representing all of Alberta’s newly produced goods and services, is predicted to fall 2.7%, mainly due to the fire. It fell 3.7% last year. It’s a back-to-back plunge not seen since the last Alberta oil crash in the 1980s.

Real exports were expected to go up by 1.9%. Instead, they’re now predicted to fall 1.7%.

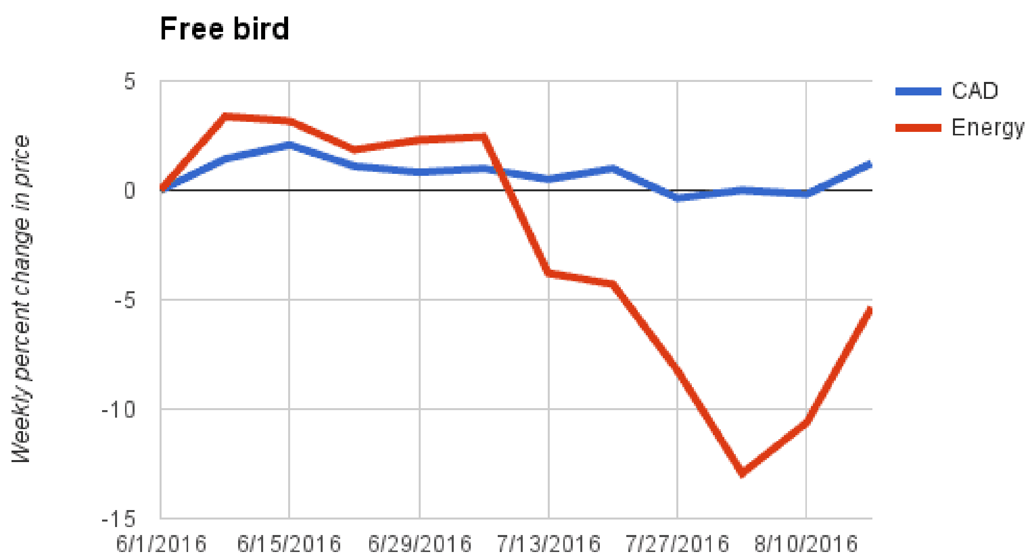
Alberta will rack up $32 billion in debt this year and remains on track for $58 billion in debt by 2019.

Debt servicing costs have now surpassed $1 billion a year and Alberta’s debt-to-GDP ratio is up to 10.25%.

Opposition Wildrose critic Glenn van Dijken said the NDP needs to create a plan to balance the books by reducing spending and streamlining services, rather than simply wishing high oil prices will return.
“If we don’t act now, it will only mean higher taxes for future generations and less services,” said van Dijken.
Progressive Conservative Leader Ric McIver agreed.
“It’s evident that the NDP has no intention of being responsible stewards of taxpayer dollars and will forge ahead with their reckless agenda, no matter what it ends up costing Albertans,” said McIver in a news release.
Alberta Party Leader Greg Clark said NDP policies are failing Albertans, starting with a hike of the corporate tax rate to 12% from 10%.
“Despite big corporate tax increases, Alberta’s tax revenues are way down and will continue to drop because the NDs have done nothing to create a positive investment climate,” Clark said in a news release.
“In fact, they’ve done the opposite.”

7. Why the loonie is still flying high despite the economic storm clouds

[August 23, 2016] Iraq, one of the world’s biggest oil producers, will increase its exports of the stuff by about 5% this week, Bloomberg reported over the weekend. State-run Northern Oil Co. worked out its differences with the Kurdistan Regional Government, the semi-autonomous authority that had closed the pipeline Northern Oil was using to get crude from three fields to market.
As one would expect, global prices slumped on the news. A three-week rally that saw West Texas Intermediate surge to more than $48 from about $40 at the start of the month ended unceremoniously on Aug. 22.
Noteworthy, however, was the reaction of the Canadian dollar: its value barely changed. That’s not what is supposed to happen. Everyone knows the Canadian currency is lashed to oil. When prices fell, the loonie should have descended. The tight link between the Canadian dollar and crude is broken.

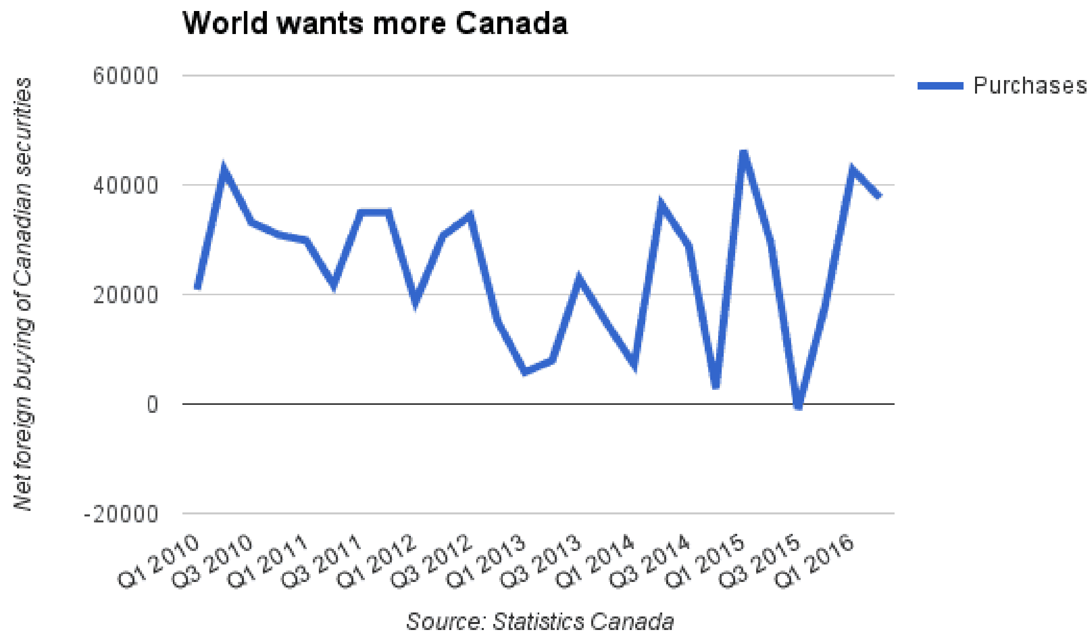


The blue line above is the average weekly change in the Canadian Dollar Effective Exchange Rate Index, a weighted average the loonie's value against the currencies of Canada's six biggest trading partners. The red line is the Bank of Canada's index of energy prices. Oil prices sank in July, as the central bank thought they might. Policy makers might have hoped the currency would sink, too. They have been leaning on the benefits of a weaker exchange rate to support their thesis that Canada's economy is destined to rotate to manufacturing and non-energy exports. But any exporter trying to compete solely on price this summer got no help from the exchange rate. The currency has traded between about 76 U.S. cents and 78 U.S. cents all year.

Many on Bay Street have struggled to explain the currency's buoyancy. The loonie touched its high for the year earlier this month even as negative economic indicators piled up. The trade deficit widened to a record, suggesting a drop in demand for Canadian goods and the currency needed to buy them. "To all but the loonie, Canada's economic malaise has become increasingly apparent," the Globe and Mail wrote on August 8. The article included three economists—from BMO Nesbitt Burns, Gluskin Sheff + Associates, and Bank of Nova Scotia—and all bet the currency was due for a fall because the data didn't jibe with a stronger exchange rate. The currency was trading around 76 cents when that article was published and climbed above 78 cents on Aug. 18. The exchange rate lately has been hovering around 77 cents. That's not much of a decline.

Currency markets are a torrent of conflicting pressures in this post-crisis era, making the old rules of thumb poor guides. It's true that Canada no longer is a shining star of the global economy. But nor is it any danger of collapse—which makes it look pretty good against post-Brexit Britain and the European Union. The International Monetary Fund predicts Canada's gross domestic produce will expand almost 2% next year, faster than every other Group of Seven country with the exception of the United States. Currency traders care more about the future than the past.

Dated economic indicators are relevant only because they help predict whether central banks will raise or lower interest rates. The Bank of Canada has made it pretty clear that it sees no reason to cut interest rates. With borrowing costs either near zero or negative in the biggest advanced economies, that makes Canada a relatively attractive place to stash money. The number of countries rated "AAA" by all three of the main credit rating agencies is down to four: Canada, Denmark, Norway and Luxembourg. International purchases of Canadian securities were near record levels in the second quarter, Statistics Canada reported on Aug. 18.



In the aftermath of the financial crisis, Canada became a haven for risk-averse international investors. Demand for Canadian bonds and other financial assets drove the currency to par with the U.S. dollar. That won't be repeated. The U.S. economy is relatively stronger and the Federal Reserve's next move probably will be to increase interest rates. But Canada still is very attractive for low-risk investors who would like to earn a little money on their

investments. That will put upward pressure on the currency, offsetting negative economic news. Non-Canadians added more than $80 billion to their portfolios in the first half of 2016, the most ever over a six-month period, according to National Bank of Canada senior economist Krishen Rangasamy. "Strong portfolio inflows explain in part the resilience of the Canadian dollar amidst persistently weak oil prices," Rangasamy said in a research note.

8. Average price for GTA low-rise home exceeds $900,000

[August 22, 2016] The average price of a new low-rise home in the GTA has surpassed $900,000 for the first time, says the Building Industry and Land Development Association (BILD).

The average price of new detached and semi-detached houses and townhomes was $906,508 for July–that's a 12% increase from July 2015.

Semi-detached homes showed the strongest price increase, growing by $196,546 in just one year. These homes reached a new record high of $771,530. For townhomes, the average price was $758,434, an increase of $122,491 over last year.

The price of single-family detached homes in July was $1,095,910. They first surpassed the $1 million mark in March of this year.

High-rise homes grow in size, price

The price of high-rise homes in the GTA also reached new heights in July. The new $475,764 average is a 7% increase over last year, and is attributed to increases in price per square foot and larger suite sizes. For example, the average price per square foot climbed to $594. And, suite sizes for mid and high-rise condo units increased to an average of 801 square feet.

"In previous years, many builders were focusing on offering smaller and more affordable units to help first-time buyers enter the market," says BILD president and CEO Bryan Tuckey. But, "recent months have seen the introduction of larger suites to meet the demands of the growing range of buyers who have been priced out of the low-rise market."

He adds, "New low-rise home prices have grown exponentially due to limited supply. Provincial intensification policies, delays in the approvals process and a lack of serviced developable land in the GTA has reduced the amount of new homes coming to the market."

Record-low supply

The supply of new homes in builders' inventory has fallwn to a 10-year low, with just 17,213 new homes available for sale in all of the GTA as of July 31.

This is a 41% decrease from a decade ago, when inventory levels were at 29,238 homes.
Only 1,568 of those homes were ground-related, which is another record low. Consider that this is less than half the homes available in July 2015, when there were 4,550. Also, it's dramatically fewer than the 16,424 available for purchase in July 2006.
High-rise supply also declined in July, falling to 15,645 units. The most significant decrease was in the pre-construction stage units, which were down 25% from last year to 8,499.

A look at new home sales

One factor driving price surges is lack of supply. In fact, sales of new homes and condominiums in the first seven months of 2016 were the highest in 10 years.
So far this year, there were 28,208 homes sold–of those sales, 15,852 were high-rise homes. That is 36% more than the 10-year average.
Low-rise sales have also been stronger than average so far this year (at 12,356) but they are down 7% from the last year.
New-home sales in July were up 12% from 2015, and 9% above the 10-year average with 3,131 transactions. The majority of the sales came from the high-rise market, with 2,226 homes sold (a 52% increase since last July).
Meanwhile, low-rise sales fell to 905 homes in July, down 32% from the previous year.
"The industry's biggest challenge is bringing enough new homes to market to satisfy demand," Tuckey says. "Projects are being sold as soon as they come to market, which is driving up prices and reducing choice for new-home purchasers."
A detailed breakdown of new-home sales in municipality across the GTA can be found below.

July new home sales by municipality:

July '16	Low-rise			High-rise			Total		
Region	2014	2015	2016	2014	2015	2016	2014	2015	2016
Durham	250	214	357	20	21	165	270	235	522
Halton	232	178	43	264	68	77	496	246	120
Peel	390	476	104	52	94	142	442	570	246
Toronto	80	41	98	911	977	1,656	991	1,018	1,754
York	353	431	303	267	301	186	620	732	489
GTA	1,305	1,340	905	1,514	1,461	2,226	2,819	2,801	3,131
Jan-July	11,169	13,268	12,356	12,552	12,662	15,852	23,721	25,930	28,208

Source: Altus Group

Have a nice and fruitful week!