Weekly Updates Issue # 586

1. Weekly Markets Changes
2. Do economists understand the post-recession world?
3. Not the right time for BoC rate hike, says C.D. Howe council
4. Home sales edged up in September
5. Approval of EU-Canada trade deal threatened
6. Deficit to increase, says TD report
7. Hot housing market still sizzles in third quarter
8. Canadian economy more vulnerable than in 2007-2008
9. Positive signs for well-positioned junior miners

1. Weekly Markets Changes

[October 14, 2016]

S&P TSX	S&P 500	Dow Jones	NASDAQ	CAD/USD	Gold	WTI Crude
14,584.99 +18.73 +0.13%	2,132.98 -20.76 -0.96%	18,138.38 -102.1 -0.56%	5,214.16 -78.24 -1.48%	$0.7611 +0.89¢ +1.18%	$1,251.70 -6.90 -0.55%	$50.32 +0.77 +1.55%

2. Do economists understand the post-recession world?

[October 14, 2016] It's unclear whether monetary policy actions taken in America affect advanced versus emerging market countries in the same ways, said Federal Reserve Chair Janet Yellen in a speech this afternoon.

Also, says Yellen, the Fed is unsure to what extent U.S. interest rates and financial conditions are influenced by easing measures abroad.

Yellen's speech examined topics such as how financial sectors interact with economies, what really drives inflation, and whether more research is needed on the relationship between supply and demand.

Finding answers to these questions is important, she adds, because "extreme economic events have often challenged existing views of how the economy works and [they've] exposed shortcomings in the collective knowledge of economists."

She predicts the financial crisis and its aftermath might prove to be a turning point in how the economy is studied, just as the Great Depression and the stagflation crisis of the 1970s encouraged experts to think of new ways to foresee and handle crises.

The good news

What we do know is monetary policy actions in one country often spill over to other economies through three main channels, says Yellen. Those channels are:

1. changes in exchange rates;
2. changes in domestic demand, which can alter the economy's imports; and
3. changes in domestic financial conditions, such as interest rates and asset prices, that can affect financial conditions abroad.

Further, U.S. monetary policy spillovers to other economies tend to be positive, she noted in her speech, citing research by Federal Reserve staff. That research finds policies designed to lift the U.S. economy also boost activity abroad, "as negative effects of dollar depreciation are offset by positive effects of higher U.S. imports and easier foreign financial conditions."

Rate hike hints?

In her speech, Yellen didn't hint at when to expect a rate hike.

So, while "the tone of recent Fed communications has been decidedly more hawkish about a near-term rate hike, today's comments […] didn't add much clarity surrounding the exact timing of further tightening," says CIBC's Royce Mendes in a research note.

But, says Mendes, "while Yellen did point out some of the longer-term reasons for keeping interest rates lower than in previous cycles, she didn't give any indication that she's opposed to the market interpreting recent Fed communications as signaling a rate hike is imminent this year."

He finds, "The dovish tilt in her remarks has been positive for fixed income and negative for the U.S. dollar, but hasn't done anything to alter our call for a rate hike in December."

3. Not the right time for BoC rate hike, says C.D. Howe council

[October 14, 2016] The Bank of Canada should keep its target for the overnight rate at 0.5% next week, says C.D. Howe Institute's Monetary Policy Council. The BoC makes its next policy announcement on October 19 and will also release a Monetary Policy Report.

The council's call for the BoC to hold at 0.5% until April 2017 is unanimous. Meanwhile, its call for a hike to 0.75% by October 2017 was a close decision, with five of the nine council members preferring that approach; the other four prefer a rate unchanged at 0.5% at that time.

The council includes financial experts from major banks and universities, and seeks to make recommendations for upcoming Bank's of Canada interest-rate announcements.

The council says in its release that the world economy and the U.S. are continuing to expand at a moderate pace, with higher oil prices improving the environment for Canada. But, global trade and capital investment in major countries worldwide are disappointingly sluggish.
Further, members underlined several policy concerns, including the growing likelihood of a hard Brexit and uncertainty about the impact of the U.S. presidential election.
On the domestic front, council members expect demand and output to grow in the second half of 2016 and into 2017. However, they predict Canadian business investment won't respond to capacity constraints, and that has negative implications for Canada's future productive capacity.
Finally, the outlook for Canadian inflation reinforces the group's tendency to recommend an unchanged target rate, due to slow increases in wages and core inflation being balanced by the prospect of higher energy prices.
Looking forward, several council members also find that recent changes in the rules for federal-government mortgage insurance may mitigate the risks of Canadian households becoming further indebted, removing one reason for the Bank of Canada to hike earlier. The effect of government spending on infrastructure is also a consideration, as is the actions of the U.S. Federal Reserve over the next year.

4. Home sales edged up in September

[October 14, 2016] The Canadian Real Estate Association says the number of home sales edged higher in September compared with August, ending a streak of month-over-month decreases.
Sales through the association's Multiple Listing Service were up 0.8% nationally last month compared with August.
Sales were up in the Toronto region were up, while they continued to fall in and around British Columbia's Lower Mainland region, which includes Vancouver.
Compared with a year ago, the number of home sales was up 4.2% from September 2015.
The national average price for a home sold in September was up 9.5% compared with a year ago at $474,590.

5. Approval of EU-Canada trade deal threatened

[October 14, 2016] One of Belgium's regional governments has voted to reject the wide-ranging CETA trade deal between the European Union and

Canada–this threatens a complex agreement that is supposed to be signed in two weeks.
The deal requires unanimous approval from the European Union's member countries, including Belgium.
But under Belgium's constitutional rules, one of its three regions can effectively veto such a deal for the whole country. As a result, Wallonia's regional legislature rejected the deal by a 46-14 margin on Friday, with one abstention.
The francophone region of 3.5 million people fears the deal with Canada will leave the farming and industrial sectors too exposed to cheaper imports from Canada. And, environmental activists and trade unions have all warned such international deals could worsen local standards for food, work and industry.
Paul Magnette, the leader of the region of Wallonia, said Friday he would "not give the full powers to the federal government" to back the deal at an EU meeting Tuesday, where the 28 member states have to decide on full approval of the agreement.
Magnette said that "the guarantees are insufficient" and he added that labour, environmental and legal standards needed to be improved before such a deal could be approved.
"We have to say 'no' so we can negotiate," Magnette said.
The agreement has already been backed by an overwhelming majority of the 28 member nations of the EU, a bloc of half a billion people.
It is scheduled to be officially signed at an EU-Canada summit in Brussels with Prime Minister Justin Trudeau on Oct. 27–seven years after talks started under the previous Conservative government led by Stephen Harper.
The Belgian national government and the dominant Dutch-speaking region on Flanders back the deal.
"We are certainly brave," said Marie-Dominique Simonet of the Walloon Christian Democrat CdH party.
The Liberal MR party, which is also represented in the national government, was scathing. "You are taking Belgium and Europe hostage," said Virginie Defrang-Firket in the legislature. "Nobody will trust us anymore."
The EU says the Comprehensive Economic and Trade Agreement deal with Canada will improve trade, create jobs, and remove just about all tariffs and custom duties while at the same time guaranteeing European standards on anything from food and health quality to labour rights.
For many, the CETA is only a prelude to an even bigger free trade deal, called TTIP, that is being negotiated with the United States, and which has given rise already to massive protests in several member states, including Belgium (and Wallonia).

Talks are planned ahead of Tuesday to see to whether Wallonia might withdraw its rejection.

6. Deficit to increase, says TD report

[October 13, 2016] Canadians can expect to see larger and more persistent federal budget deficits, says a report from TD Economics. The major culprit? Slow economic growth, which is worse now than when the budget was released in March.

Highlights of the report:

- The deficit is on track to reach $34 billion this fiscal year (1.7% of GDP), about $5 billion higher than was shown in the budget.
- This fiscal erosion extends through the entire five-year horizon, leaving the cumulative deficit at $16.5 billion more than forecasted.
- Despite this deficit upgrade, prospects for a modestly growing economy would likely cap the federal debt-to-GDP ratio close to its current level of 31-32% through fiscal 2020/2021.
- The government will face growing calls for further stimulus, while pressure from the provinces will build for additional health transfers.
- Lowering the deficit at the expense of maintaining fiscal wiggle room isn't warranted in light of the unusually high uncertainty for Canada's economy and housing market.

7. Hot housing market still sizzles in third quarter

[October 13, 2016] the Canadian housing market continues to grow.

Vancouver leads the way, with year-over-year home prices increasing by more than 30% last quarter, despite the B.C. government's new 15% property transfer surtax on foreign nationals, introduced early in the period.

While Ontario considers a similar tax, house price increases in the Greater Toronto Area also remain strong, increasing 13.6%.

But could Q3 be the last hurrah?

"Relief appears to be on the way," says Phil Soper, president and CEO of Royal LePage, said in a release. "For months, the number of homes trading hands has been slowing on eroding affordability. And slower sales volumes lead to moderating prices."

Vancouver's real estate board reports sales dropped more than 32% in September compared to last year. And tighter controls are expected to provide additional cooling across the country.

To that end, the federal finance minister recently announced new measures, including:

- mortgage-rate stress tests for insured mortgages to determine whether borrowers can make payments if interest rates rise or they lose their jobs; and
- capital gains tax exemption eligibility for Canadian residents only, on the sale of a principal residence.

These changes come less than a year after the government increased — to 10% from 5% — the required down payment on residences selling for more than $500,000, and a month after the Office of the Superintendent of Financial Institutions imposed new capital requirements for mortgage insurers.

The change to the capital gains exemption addresses concern that foreign buyers are driving up house prices. Banks are concerned, too: both Bank of Nova Scotia and Bank of Montreal have implemented stricter income verification processes for non-residents.

And, in addition to B.C.'s property transfer surtax, policymakers in that province are considering introducing a vacancy tax on owners of unoccupied homes.

For clients looking for homes, it all adds up to less fun on the open-house circuit.

Location or housing type	**Year-over-year % increase in home price**	**Average home price (Q3 2016)**
Canada (aggregate)	12.0%	$545,414
Greater Vancouver	30.6%	$1,194,653
Greater Toronto Area	13.6%	$693,154
Greater Montreal	4.9%	$352,798
Two-Storeys (Canadian aggregate)	13.7%	$649,635
Bungalows (Canadian aggregate)	11.0%	$459,481
Condos (Canadian aggregate)	5.8%	$360,679

Source: Royal LePage house price survey

8. Canadian economy more vulnerable than in 2007-2008

[October 12, 2016] Record levels of public debt mean Canada's financial stability is more precarious now than it was in the time before the Great Recession, writes HSBC chief economist David Watt.

With the highest household debt-to-GDP ratio in the G7, Canada's over-leveraged household sector has been identified by the IMF, OECD, credit rating agencies, and the Bank of Canada as a downside risk to financial stability.

"Indeed, although it is not our base case, we believe debt levels pose a heightened downside risk to financial stability," he explains in a research report. "Along with a large current account deficit, we see Canada as more vulnerable to disruptions to global capital flows than when it was heading into the 2007-08 financial crisis.

"While consumers have been an important source of support for the economy, we look for a more moderate consumption profile given the record level of household sector indebtedness and sluggish income growth," he writes.

"Canada's private sector, in our view, is essentially tapped out," he writes.

HSBC forecasts subdued growth for Canada: low inflation, low interest trajectory, with GDP growth seen at 1.8% in 2017 and 1.7% in 2018.

Federal stimulus, in turn funded by foreign investment, will be what drives growth going forward, says Watt. He calculates that the current account deficit requires an inflow of 4% of GDP on top of stimulus measures. He cautions that measures to cool foreign investment in Canadian real estate should direct that money to more productive ends inside the national economy.

9. Positive signs for well-positioned junior miners

[October 12, 2016] Investors have seen a rise in the market capitalization of top junior mining companies on the TSX Venture Exchange by more than 100% compared to last year.

Mining companies once again make up over 50 % of the total market capitalization on the TSX Venture Exchange, up from 36% on June 30, 2015, according to PwC Canada's 2016 Junior Mine report.

For the past 12-month period between June 2015 to June 2016, cash flows from financing activities increased significantly and cash flows from debt and equity financing increased to 45 % and 48 % respectively.

The report mentions that the political and economic uncertainty around the globe provided some relief to junior mining companies by inflating the price of gold by as much as 22%. Gold is a key asset for each of the top five juniors, with the exception of the top company which focuses on uranium exploration.

"While the outlook is positive, it's too early to call it a recovery," said Liam Fitzgerald, National Mining Leader, PwC Canada. "For the past few years, executives have had to look at different and creative ways to allocate resources and capital. As investors renewed their interest in junior assets, we're now seeing market valuations close to what they were in 2012, which is encouraging."

For the most part, companies sat in the same spot of the mining lifecycle from the previous year, with a majority of them at the exploration and evaluation stage, followed by development and production stage entities.

While highlighting the state of the industry and its successes this past year, PwC also warns mining companies that there is no room for complacency. “The mining sector is moving in the right direction but executives must continue to remain cautious. By managing risk in this volatile market, they can focus on new project pipelines and investigate new opportunities for mining in locations like Nova Scotia,” adds Fitzgerald.

Report highlights

Resilience: Markets are rewarding companies run by experienced mining executives who have demonstrated creative leadership and an agile approach to capital allocation, putting these organizations in a strong position to ride any recovery.

Capital allocation: While investors are clearly more enthusiastic about gold’s future these days, a key question is capital allocation. Many made significant cuts to survive the downturn and the long-term effects of that belt tightening remain unclear. The market is now watching to see when and how these companies will begin to spend money again.

Gold rally: On a macro level, greater political and economic uncertainty around the globe has provided some lift to junior miners by inflating the price of gold, which had risen by as much as 22% by the middle of the year. The result has been the first sustained rally in gold prices since 2012, which in turn has created new enthusiasm for junior gold companies.

Have a nice and fruitful week!