Weekly Updates Issue # 636

1. Weekly Markets Changes

[October 20, 2017]

S&P TSX	S&P 500	Dow Jones	NASDAQ	CAD/USD	Gold	WTI Crude
15,857.22 +50.05 +0.32%	2,575.21 +22.04 +0.86%	23,328.63 +456.9 +2.00%	6,605.80 +23.25 +0.35%	$0.7936 -0.72c -0.90%	$1,280.47 -23.35 -1.79%	$51.45 +0.39 +0.76%

2. BoC to hold interest rate, analysts say

[October 20, 2017] Canadian financial institutions are predicting the Bank of Canada won't change its target for the overnight interest rate at its announcement next week.

In a research note on Friday, CIBC Capital Markets chief economist Avery Shenfeld suggested the central bank wouldn't raise the interest rate for a third time this year.

Citing strong economic growth, the BoC raised its key interest rate in July and again in September, up to 1%.

But analysts don't expect a third hike when the central bank announces its decision on the overnight rate target on Oct. 25.

While the Canadian economy is close to full employment and coming off strong growth in the first half of 2017, the central bank will likely opt to "monitor" it further before making another move, Shenfeld said.

"Core inflation readings are still enough below target, having been there for some time, that there's no reason to panic about an inflationary overheating just yet," he wrote.

Shenfeld also pointed to uncertainties around NAFTA and Ontario's minimum wage hike, and the "data lags" that prevent economists from measuring the quarterly impact of the September rate increase until March 2018.

"If the Bank needs to 'monitor' how the economy is doing with higher rates and other changes in the landscape, we won't see the next rate hike until the spring of 2018," he wrote.

Derek Holt, head of capital markets economics at Scotiabank Global Economics, also cited concerns around NAFTA as a reason for the bank to stay put.

"Rules governing trade with the U.S., which accounts for about one-quarter of Canadian GDP plus associated investment, are faced with a degree of uncertainty unseen in at least 25 years," he wrote in a research note Friday.

Holt predicted no increase next week, and while Scotiabank continues to forecast a hike in December, he has "reduced confidence in such expectations."

September numbers from Statistics Canada released Friday morning showed the annual inflation rate rose to 1.6%, up from 1.4% in August and a two-year low of 1% in June. The agency also reported that retail sales declined slightly in August.

Citing those numbers, Desjardins also predicted the central bank would maintain the status quo.

"Today's results confirm that Canada's runaway economic growth started to wind down in the third quarter, which reduces the urgency to swiftly proceed with monetary tightening in Canada," senior economist Benoit P. Durocher said in a research note.

3. U.S. Senate paves way for Trump tax cuts

[October 20, 2017] President Donald Trump promised tax cuts Friday "which will be the biggest in the history of our country!" following Senate passage of a $4 trillion budget that lays the groundwork for Republicans' promised tax legislation.

Republicans hope to push the first tax overhaul in three decades through Congress by year's end, an ambitious goal that would fulfil multiple campaign promises but could run aground over any number of disputes. Failure could cost the GOP dearly in next year's midterm elections.

The budget plan passed on a near party-line vote late Thursday includes rules that will allow Republicans to pass tax legislation through the Senate without Democratic votes and without fear of a Democratic filibuster. Nonetheless, the GOP's narrow 52-48 majority in the Senate will be difficult for leadership to navigate, as illustrated by the Republicans' multiple failures to pass legislation repealing and replacing "Obamacare."

The final vote on the budget was 51-49 with deficit hawk Sen. Rand Paul of Kentucky the lone opposing GOP vote.

Trump insisted over Twitter Friday that Paul would be with him in the end on taxes, even though the senator has been critical of the tax package as it's emerged thus far.

The House has passed a different budget but House Republicans signalled they would simply accept the Senate plan to avoid any potential of delaying the tax measure.

"I look forward to swift passage and to working with the president on tax reform," House Budget Committee Chairman Diane Black, R-Tenn., said Friday.

Republicans are looking for accomplishments following an embarrassing drought of legislative achievements despite controlling both chambers of Congress and the White House. Republican lawmakers publicly admit that failure on taxes would be politically devastating with control of the House and Senate at stake in next year's midterm elections.

"It would be a complete disaster," Sen. Lindsey Graham, R-S.C., said after the final budget vote.

But Republicans are split on taxes. A restive rump of House Republicans from high-tax states like New York, New Jersey, Illinois and California staunchly oppose the tax plan's proposed elimination of the federal deduction for state and local taxes. They maintain it would hurt low- to mid-income taxpayers and subject them to being taxed twice.

Their vocal opposition has led Republican leaders in Congress like House Speaker Paul Ryan and Rep. Kevin Brady, R-Texas, who heads the tax-writing Ways and Means Committee, to hear out the fractious GOP members and seek a compromise with them.

At the same time, the White House is making overtures to conservative Democrats in the House and Democratic senators from states that Trump won in the 2016 election. Most heavily courted have been Sens. Claire McCaskill of Missouri, Joe Manchin of West Virginia and Heidi Heitkamp of North Dakota. The trio dined this week at the home of daughter Ivanka Trump and her husband, Jared Kushner, both top advisers to Trump.

But Manchin said after Thursday's vote, "I fear that passage of this budget today will make it difficult to pass bipartisan tax reform in the coming weeks."

In his conversations with Trump, Manchin said, "we have discussed our shared goal of ensuring any tax-reform package passes with both Republican and Democratic votes, and focuses on providing tax relief for working Americans. The current tax-reform proposal … does not reflect my conversations with the president."

The Democrats were excluded from the drafting of the tax blueprint, and they continue to demand that any tax-cutting plan not add to the mounting $20 trillion national debt. The newly-adopted Senate budget plan provides for $1.5 trillion over 10 years in debt-financed tax cuts, busting earlier Republican pledges of strict fiscal discipline.

The money would be used for the tax plan's cut in the corporate tax rate from 36% to 20%, reduced taxes for most individuals, and the repeal of inheritance taxes on multimillion-dollar estates. The standard deduction would be doubled, to $12,000 for individuals and $24,000 for families, the number of tax brackets would shrink from seven to three, and the child tax credit would be increased.

Trump and the Republicans pitch the plan as a boon to the middle class and a spark to economic growth and jobs. Democrats charge it mainly would benefit wealthy individuals—like Trump—and big corporations.

4. September inflation rate approaches BoC target

[October 20, 2017] Canadian consumer prices picked up their pace last month as the annual inflation rate moved up from very low levels and closer to the Bank of Canada's ideal target of 2%, Statistics Canada said Friday.

Higher gasoline prices helped push the annual inflation rate in September to 1.6%, up from 1.4% a month earlier and away from its two-year low of just 1% in June, the agency said. Excluding gas prices, inflation was 1.1%.

The inflation-targeting central bank scrutinizes inflation ahead of its rate decisions. Its next benchmark rate announcement is scheduled for next Wednesday.

However, only one of the bank's three preferred measures of core inflation, which seek to look through the noise of more-volatile items, increased last month while the others stayed put.

Statistics Canada also released numbers Friday that showed retail sales contracted 0.3% in August, after increasing 0.4% in July. Retail sales volumes in August recoiled 0.7%.

Excluding sales at gas stations and auto dealers, the report said retail trade was down 1.3% in August. Sales were also down 2.5% at food and beverage stores and 2.4% at furniture and home furnishings stores.

The retail sales data suggests the economy is starting to show signs of slowing down, as widely expected, following its red-hot performance in the first half of the year.

"One soft month for retail trade won't ruin the 2017 party," CIBC senior economist Nick Exarhos said in a note. "A very slow turn in prices, and what looks like another ho-hum month for GDP augurs for a dovish take on the Bank of Canada on Wednesday next week."

On inflation, the report highlighted gasoline, travel tours and air transportation as the biggest upward contributors to consumer prices. The downward pressure was led by cheaper electricity, women's clothing and furniture.

The report also found that consumer prices rose in seven of the 10 provinces in September.

Below are the September inflation rates for the provinces and territories (previous month in brackets):

- Newfoundland and Labrador: 1.4% (1.2)
- Prince Edward Island: 2.4% (2.3)
- Nova Scotia: 1.3% (1.1)
- New Brunswick: 1.7% (1.8)
- Quebec: 1.0% (1.1)
- Ontario: 1.7% (1.5)
- Manitoba: 1.5% (0.9)
- Saskatchewan: 1.9% (1.7)
- Alberta: 1.3% (1.1)
- British Columbia: 2.0% (2.0)
- Whitehorse, Yukon: 1.1% (0.6)
- Yellowknife, N.W.T.: 0.5% (0.4)

5. Canadian credit and debit cards spending up 5%: report

[October 19, 2017] Credit and debit card spending in Canada grew 5.05% in dollar volume during the third quarter of 2017 over the same period last year, finds a Moneris Solutions Corporation report. This quarter marks the highest 2017 quarterly year-over-year growth.

"All year we've seen a strong and steady climb in spending, and this quarter continues the trend, putting Canada's economy in a good position moving into the holiday season," says Angela Brown, president and CEO of Moneris. "This growth is in line with the Bank of Canada's expectations reflected in its increase of the overnight rate target to one per cent in September. We expect to see an encouraging end to 2017."

The results are on trend with other economic indicators, says the firm. While Canada's GDP remained flat in July, average weekly earnings and retail sales, posted by Statistics Canada during the July time period, increased. The

Moneris report shows both debit card and credit card spending increased year over year, with a 3.08% and a 6.11% growth in dollar volume, respectively.

Provincial breakdown

This quarter measured positive growth for all provinces except Saskatchewan, where spending was down 0.27%.

Newfoundland rebounded from last quarter's decline with an increase of 1.17% over last year and Alberta continued a trend of positive growth with an increase of 3.08% over the same quarter in 2016.

Ontario (5.62%), British Columbia (6.32%), Quebec (5.48%) and Nova Scotia (4.95%) all posted strong growth.

Contactless payments sustain growth

Contactless payments continued to surge in Canada this quarter. There was a 51.53% increase in the amount of tapped dollars over 2016. Further, the total number of contactless transactions increased by 48.35% over the same period in 2016.

These increases align with the continued expansion of tap-and-pay options. For example, Q3 2017 was the first full quarter since Android Pay launched in Canada. However, the rate of new adoption has slowed when compared to the same quarter in 2016, when spending on contactless was up 145.06% year over year. This further indicates that contactless payments have become a mainstream option for Canadians.

Foreign visitor spending up

July was the strongest month of the quarter, with 5.96% year-over-year growth, followed by August (5.73%). September posted the lowest growth at 3.95%.

Canada's 150th birthday celebration may have contributed to the spending surge from international visitors in the third quarter, with an increase of 12.16% in spending on foreign cards over the same quarter in 2016.

The biggest year-over-year increases in terms of dollars spent came from visitors from the U.S. (up 10.86%), China (up 19.85%) and Mexico (up 66.76%).

Short- and long-term spending

The increase in travellers may have contributed to the quarterly rise in spending in travel-related categories, including hotels, which were up 7.80%, and restaurants, up 7.73% year over year. Fast food had an even bigger increase, up 13.43% over the same time last year.

Canadians also focused their spending closer to home, with longer-term investments in home improvement and vehicle purchases. The home improvement category, which includes general contractors, lawn and garden supplies, hardware stores and roofing and siding suppliers, saw overall growth of 6.68%. Similarly, vehicle purchases were up 6.36% year over year.

"It's encouraging to see growth spread across a variety of different industries," says Brown. "Visitors to our country, as well as Canadians, clearly enjoyed the summer months to their fullest. But based on the data, Canadians are also looking ahead and making practical, longer-term investments."

6. Commodities make a small gain in September

[October 17, 2017] The Scotiabank Commodity Price Index eked out a small gain of 0.7% month over month in September, with industrial commodity strength (+1.9%) outweighing losses in the agriculture index (-4.0%).

Energy markets are experiencing gradual, range-bound recoveries against volatile metals performance. While metals rallied together in the third quarter, prices are diverging again as individual fundamentals reassert control.

"These market-specific developments are occurring against a widely supportive backdrop, where an accelerating global economy is bolstering commodities demand and broad U.S. dollar weakness is putting upward pressure on dollar-denominated contracts," says Rory Johnston, commodity economist at Scotiabank. "We anticipate that most industrial commodities will continue to gain in year-over-year terms through the forecast horizon, though bulk commodities are expected to undergo a needed correction and precious metals prices are forecast to fall back on a higher rate environment."

The oil market is rebalancing much as expected but prices have lagged the gradual recovery occurring in the physical market, with still-high commercial inventories providing ample cover for bearish sentiment and tilting speculative price movements to the downside. Sentiment headwinds will slow the recovery in crude prices, which are expected to average $50/bbl in 2017, $52/bbl in 2018, and $56/bbl in 2019.

However, continued strengthening in fundamentals will tilt medium-term risk to the upside and ultimately drive prices higher through to the end of the decade, with supply deficits expected to reduce the overhang in OECD commercial inventories back to five-year average levels by mid-2019.

Base metals markets experienced a collective third quarter rally, though prices have since diverged and metal-specific fundamentals are expected to drive individual performance through the forecast horizon. In the world of precious metals, the price of gold remains elevated after briefly breaching $1,350/oz, its highest level of the year, on falling market expectations of interest rate hikes in the U.S., a weakening U.S. dollar, and heightened geopolitical risk related to North Korea.

Here are some additional highlights:

- North American natural gas markets are closer to their anticipated long-term balancing level than oil, but prices will be weighed down through 2018 by the delay of expected natural gas power plant start-ups.
- Copper prices are expected to average $2.85/lb in 2018 and $3.00/lb in 2019.
- A gradual reduction of nickel inventories is forecast to put soft upward pressure on prices, which are expected to average $4.65/lb in 2017, $5.00/lb in 2018, and $5.50/lb in 2019.
- Zinc continues to enjoy the strongest fundamentals within the base metals complex and supply tightness is expected to push prices higher than today's already-inflated levels, averaging $1.50/lb in 2018 and peaking at $1.60/lb in 2019.
- Bulk commodities like iron ore and coking coal have continued to surprise on the upside after receiving a demand jolt from newly profitable Chinese steel mills.

7. The financial impact of cuts to Ontario's hydro bills

[October 17, 2017] Ontario's auditor general says the way the Liberal government is cutting hydro bills by 25% purposely obscures the true financial impact of the measure to avoid showing a deficit on the province's books.

Bonnie Lysyk estimates the plan's total cost will be $39.4 billion over 30 years, but the accounting the government is using in the plan means Ontario's net debt and future deficits won't reflect that.

The hydro plan lowers time-of-use rates by removing from bills a portion of the global adjustment, a charge consumers pay for above-market rates to power producers, for the next 10 years.

In the meantime, producers will continue being paid the same, so Ontario Power Generation has been tapped to oversee the debt used to pay that difference.

The cost of paying back that debt with interest will then go back onto ratepayers' bills for the following 20 years, and Lysyk estimates the total cost will be $18.4 billion borrowed to cover the shortfall, and $21 billion in accumulated interest.

Lysyk says the financing structure is needlessly complex and also leads to about $4 billion in extra interest charges because the province isn't directly borrowing the money.

The government says it doesn’t agree with Lysyk’s conclusions, saying their financing structure is indeed in compliance with accounting standards.
Premiere Kathleen Wynne has said the extra interest costs related to the plan would amount to $25 billion over 30 years.
Electricity bills in the province have roughly doubled in the last decade, due in part to green energy initiatives, and the government has said this plan better spreads out those costs, instead of putting the entire burden on current ratepayers.

8. Mexico and Canada slam U.S as NAFTA talks are pushed into 2018

[October 17, 2017] Government officials from Canada and Mexico slammed the Trump administration's proposals to renegotiate NAFTA in front of the top U.S. trade negotiator on Tuesday. He, in turn, lambasted the two leaders as they were standing right next to him during a televised news conference.
"We have seen proposals that would turn back the clock on 23 years of predictability, openness and collaboration," Canadian Foreign Minister Chrystia Freeland said in Washington.
"We must ensure that decisions we make today do not come back to haunt us tomorrow," Mexico Economy Secretary Ildefonso Guajardo added, alluding to the U.S. proposals to rework the free trade pact.
Robert Lighthizer, the U.S. Trade Representative, didn't mince words in response to the criticism.
"I'm surprised and disappointed by the resistance to change from our negotiating partners," Lighthizer said with Guajardo to his left and Freeland to his right. "We have seen a refusal to accept what is clearly the best text available."
The verbal blows concluded Round 4 of talks to renegotiate NAFTA.
All sides remain committed to talks for now: The next round will be in Mexico City starting November 17. Negotiations are now expected to go into the first three months of 2018, according to Lighthizer.
Canadian and Mexican officials rejected some U.S. proposals introduced during the latest round, according to one government source from each country.
Despite a two-day extension, talks this week ended without any progress on a few key issues.
Canada opposed a U.S. provision designed to create more jobs for American manufacturers of cars and parts, the Canadian source said. It also rejected the Trump administration's suggestion that the trade agreement should be up for

renewal every five years. Freeland also made it clear that Canada opposed an American proposal to rewrite how companies resolve disputes.
"We made it clear that these are issues that from the Canadian side are non-starters," said the Canadian source, speaking on the condition of anonymity.
Mexico also opposed the five-year provision, known as a sunset clause, the Mexican source said. Guajardo, Mexico's top negotiator, had already made his opposition clear to the other proposal on auto production.
The first key disagreement is over "rules of origin." It governs how much of a car has to be manufactured in North American to avoid import taxes in the three countries that make up NAFTA.
Under current rules, at least 62% of the parts have to come from North America to avoid border taxes. It doesn't matter if the car parts are made in Mexico, Canada or the United States, as long as they were produced in North America.
The U.S. proposed raising that threshold to 85%, according to the Canadian government source. The U.S. also proposed that half of the parts that come from North America must originate from the United States.
So instead of one rule for all of North America, the Trump administration is suggesting two -- one for the U.S., one for all of North America.
"We are opposed to country-specific required rules of origin," the Canadian source said.
"There is no one trade agreement in the world that has country-specific content. It doesn't exist," Guajardo said. "Content has to be measured regionally."
Under the sunset clause, the agreement would expire every five years unless all three nations agree to sign on for five more. Critics say it would create too much uncertainty for foreign investment. Canada and Mexico won't stand for it.
"We couldn't accept it," the Mexican government source said Tuesday.

9. OSFI introduces stress test for homebuyers

[October 17, 2017] Canada's banking regulator has published the final changes to its guidelines for residential mortgage underwriting, including a financial stress test for buyers who don't need mortgage insurance.
The Office of the Superintendent of Financial Institutions (OSFI) says Tuesday the changes will come into force by January 1, 2018.
Even homebuyers who don't require mortgage insurance because they have a down payment of 20% or more will have to prove they can continue to make payments if interest rates rise.

“Broadening the stress test will likely further slow housing activity, depressing demand by 5% to 10% once implemented, with some pull-forward of activity likely to take place ahead of the January 1 implementation date,” says Brian DePratto, senior economist at TD Economics, in a release. “Price growth will also be impacted, with these changes expected to exert a drag of between 2% and 4% over 2018. On balance, these changes should help enhance the resilience of the Canadian banking system in a rising interest rate environment.”

Other changes include restrictions on co-lending, or bundled mortgages, aimed at ensuring financial institutions do not circumvent rules that limit how much they can lend.

The final guidelines are generally similar to what OSFI had proposed in July, when the regulator put out a draft for public consultation.

The proposed changes, however, have been criticized for including potentially increasing costs and limiting access to mortgages for some home buyers.

“These revisions to Guideline B-20 reinforce a strong and prudent regulatory regime for residential mortgage underwriting in Canada,” says superintendent Jeremy Rudin in a statement on Tuesday.

Have a nice and fruitful week!