Weekly Updates Issue # 637

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1. Weekly Markets Changes

[October 27, 2017]

S&P TSX	S&P 500	Dow Jones	NASDAQ	CAD/USD	Gold	WTI Crude
15,953.51 +96.29 +0.61%	2,581.07 +5.86 +0.23%	23,434.19 +105.6 +0.45%	6,701.26 +95.46 +1.45%	$0.7806 -1.30c -1.64%	$1,271.80 -8.67 -0.68%	$53.90 +2.45 +4.76%

2. Expect losses for the loonie

[October 27, 2017] All signs point to downside ahead for the loonie.
"The Canadian dollar is still mispriced," says Benjamin Tal, deputy chief economist at CIBC World Markets, in a weekly economics report. "Too many factors are pointing in unison to one direction: a lower loonie."
First off, he notes the full cent drop following the Bank of Canada (BoC) move this week to maintain its benchmark rate, calling the drop highly predictable.
"It was an easy trade. And that trade is still very attractive," says Tal.
Another factor to the downside is a potentially more aggressive Fed, depending on who's appointed chair.
"It's between Jerome Powell and John Taylor," says Tal, with the latter perceived as more aggressive on monetary policy. If Taylor becomes chair, his reputation could cause the markets to price in a more aggressive Fed — a negative for the loonie.
Further, if Trump makes progress with tax reform — even perceived progress — U.S. small caps would benefit and put downward pressure on the loonie, he adds.
Other potential factors include the Canadian market's too-high expectation for a December rate hike, along with NAFTA uncertainty.

In fact, Tal says two-thirds of Canadian SMEs say NAFTA uncertainty is affecting their investment decisions, and a greater number of larger firms would probably say the same thing.

"The apathy in the FX market to that unfolding reality is mind boggling," he says.

Meanwhile, "U.S. monetary policy is leaning in the tighter direction, amid a roaring equity market, a hotter economy, potential tax cuts and, possibly, a somewhat less dovish Fed chair," says Douglas Porter, chief economist at BMO, in a weekly economics report. "This sudden reversal of fortune in the rate outlook between the U.S. and Canada is the reason the loonie has slid 6% in a matter of weeks, and why it looks to stay at a low ebb for some time yet."

Say Tal: "We see the loonie depreciating even more than previously forecast, with USDCAD hitting 1.33" in the first quarter of 2018.

3. StatsCan data offer insight on immigrants' income

[October 27, 2017] StatsCan census data from 2016, released this week, shed light on immigrants' financial status, as summarized in an economics report by Scotiabank economist Marc Desormeaux.

For example, immigrant incomes in 2014 were 86% of Canadian-born workers' earnings, he finds.

Last year, a StatsCan report revealed that, one year after immigration, the median employment income of immigrant taxfilers who landed in Canada in 2013 was $22,000. The median income for those who landed in 2011 or 2012 was $21,000 one year after landing in Canada.

Referring to the 2016 data, Desormeaux says, "Newcomers to Atlantic Canada fared the best, with incomes greater than other residents' in every province but P.E.I., led by immigrants in St. John's and Saint John."

However, "in Toronto and Vancouver, the earnings gap exceeded 25%," he says, "and it also was stubbornly high across the Prairies."

Economic immigrants on the rise

Related to incomes is the rising share of immigrants admitted under the economic category. The category includes immigrants selected for their skill sets or ability to invest, create their own employment or meet specific Canadian labour market needs.

Economic immigrants rose to more than 60% during 2011-16, from 42% during the 1980s, says Desormeaux.

Immigrants follow the economy

Toronto, Montreal and Vancouver remain the most prominent destinations for immigrants, accounting for more than half of total and economic immigrants during 2011-16 — larger than their 36% population share.

“Economic conditions in the various receiving regions undoubtedly played a major role in the geographic distribution of immigrants,” says StatsCan in a report.

First-generation immigrants accounted for 21.9% of the Canadian population in 2016.

4. No love for finance minister despite pledge to donate share earnings

[October 27, 2017] Bill Morneau made further attempts on Thursday to silence accusations that he’s personally profited from decisions he’s taken as federal finance minister.

He announced he’ll donate to charity any gains in the value of his family business’s shares since he was elected two years ago.

But that announcement was immediately undercut by news that the federal ethics watchdog is looking into opposition accusations that Morneau was in a conflict of interest when he introduced a pension bill that could benefit Morneau Shepell — his family’s pension management and human resources firm in which the minister still owns some $21 million worth of shares.

“Your letter leaves me with concerns in relation to Mr. Morneau’s involvement with Bill C-27,” ethics commissioner Mary Dawson wrote Thursday in response to a complaint lodged last week by NDP ethics critic Nathan Cullen.

“Consequently, I will follow up with Mr. Morneau and will inform you of the outcome in due course.”

Morneau announced last week that he will sell all of his roughly one million shares in Morneau Shepell and put all his other considerable assets in a blind trust.

In a bid to finally spike continuing opposition accusations that his actions as minister could have increased the value of those shares, he went one step further on Thursday. He announced that he will donate to charity the difference in the value of the shares between the date he was elected in 2015 and the day they’re sold.

Morneau made the announcement in the House of Commons after meeting with Dawson. He said later that she agreed this additional action was “appropriate.”

Morneau said he doesn't know how much his decision will wind up costing him but it could be as much as $5 million.
"Whatever the value is, that's our decision […]. My goal is to make sure that I'm doing the work that I came here for," he said outside the Commons.
"For me, the work that I'm doing right now is the most important work that I will ever do, and I want to make sure that Canadians have confidence in that work […]. Taking these extra steps to give absolute assurance is important."

Reaction to Morneau

The announcement did little to quell opposition accusations that Morneau's failure to divest his Morneau Shepell shares or put them in a blind trust when he first took office two years ago put him in blatant conflict of interest.
Cullen quickly labelled the donation "guilt money."
"I think what we saw today was an admission of guilt. From my experience, people don't generally pay a fine or a fee if they're innocent of something," Cullen said.
"He's in a conflict of interest that helped his own personal wealth grow substantially, and now he's saying, 'I've got to put some guilt money together and try to buy my way out of this problem.'"
Conservative MP Gerard Deltell similarly said Morneau's announcement "is just proof, without a shadow of a doubt, that he was in a pure, profitable conflict of interest for the last two years, and he only acts when he's trapped in a corner."
Conservative finance critic Pierre Poilievre pointed out that the donation will entitle Morneau to claim a charitable tax deduction. He suggested Morneau should donate those tax savings to offset the billions he's added to the federal deficit.
Both opposition parties have zeroed in on Bill C-27, legislation aimed at allowing pension administrators to convert direct benefit pension plans into targeted benefit pension plans — a change for which Morneau Shepell had lobbied.
Cullen said the value of the company's shares went up immediately after the bill was tabled and he estimated that Morneau personally gained $2 million in just five days as a result. He acknowledged there was a "big drop" in the value of the shares subsequently.
Nevertheless, Cullen said the fact that Morneau was regulating an industry in which for two years he's had a personal interest "leaves Canadians in doubt" about his ethics.
Morneau introduced C-27 just over a year ago, and it has sat on the Commons order paper ever since. There has been no debate on the bill and no attempt by the government to move it along.

5. Canada’s housing market ‘highly vulnerable’: CMHC

[October 26, 2017] Canada Mortgage and Housing Corp. says the country’s housing markets remain “highly vulnerable” with evidence of moderate overvaluation and price acceleration.

The national housing agency says in its quarterly housing market assessment that markets in Toronto, Hamilton, Vancouver, Victoria and Saskatoon are highly vulnerable.

The housing market assessment gauges the overall level of risk by evaluating four problematic conditions: overheating, price acceleration, overvaluation and overbuilding.

It noted that despite the recent easing in Toronto’s resale market, it detected moderate evidence of price acceleration with strong growth in home prices among all housing types.

CMHC says Vancouver’s housing market remained highly vulnerable, with evidence of moderate overheating and price acceleration, and strong overvaluation.

In its housing market outlook, which was also released today, CMHC says that after a boost this year, housing starts are expected to decline by 2019, but remain close to the average level from the last five years.

Sales in the existing-homes market are also expected to decline relative to the record level set in 2016, while price growth is expected to slow, CMHC says.

6. Banks’ predictions for the next BoC rate hike

[October 25, 2017] This week, the Bank of Canada held fast to its 1% benchmark rate.

In a report, Desjardins economists describe the historically low rate as “reflective of highly expansionary monetary policy.” They thus expect normalization of rates in the coming quarters, albeit at a gradual pace.

“A third increase could be announced either in December or, more likely, in early 2018,” say François Dupuis and Benoit Durocher, Desjardins chief and senior economist, respectively.

More specifically, Douglas Porter, BMO chief economist, says in an economics update, “We have pushed back our call on when the [BoC] may now hike rates (to March from January) and the number of hikes next year (to three from four).”

That’s because of risks cited by the BoC in today’s monetary policy report, such as ongoing NAFTA negotiations and OSFI mortgage measures.

"We have also trimmed our outlook on the Canadian dollar in 2018 (from an average of almost 82 cents to closer to 78 cents [U.S.])," says Porter.
Likewise, Nick Exarhos, director at CIBC World Markets, says in a note that he still expects the next rate hike won't come until spring.
Further, "We continue to see the C$ weakening to 77 cents U.S. (USDCAD 1.30) by the early part of 2018," he says.
Last week in a weekly economics report, TD economist Dina Ignjatovic said the BoC's "forthcoming communication is key in assessing the future path for interest rates."
Commenting that the output gap is closed and inflationary pressures are modest, Brian DePratto, senior economist at TD, says in a rate update, "There does not appear to be any immediate urgency to further increase interest rates, although this sweet spot also clearly implies that the current low level of rates will become increasingly unneeded."

A December call?

Derek Holt, vice-president and head of Scotiabank capital markets economics, also refers to NAFTA and OSFI tightening measures, saying in a daily report, "Our last print forecast in early October was for a hike in December but with lessened confidence now, given material new developments."
Holt hasn't explicitly revised his rate forecast since today's hike, but says in BoC commentary, "Market odds of a hike in December have dropped to about one in three post-statement, the C$ depreciated by a full cent, with USDCAD presently at about 1.2790, and the two-year GoC yield shed about 5 bps."
In an economics update, RBC economist Josh Nye says, "Our current forecast is for the overnight rate to be raised to 2% by the end of next year." That assumes a rate hike in December, he adds, although such a move is less likely given the bank's dovish tone today.
"There is a risk that the Bank of Canada holds off on resuming tightening until early 2018," he says.

7. Renters face financial challenges as home ownership drops

[October 25, 2017] If you are a renter, you are more likely to be over-stretched financially to keep a roof over your head.
That's because almost 40% of renters captured in the 2016 census spent more than 30% of their average monthly income on housing, finds StatsCan. That figure is largely unchanged from 2011 and more than double the approximately 17% recorded for homeowners.

The census also reveals that 30-year-old Canadians are less likely to own a home today than their baby boomer parents did at the same age, mirroring a modest but unmistakable decline in the national home-ownership rate.

At age 30, 50.2% of millennials owned their homes, compared to 55% of baby boomers at the same age. Young adults today are more likely to live in apartments than their 1981 counterparts, are less likely to live in single-detached homes, and — as StatsCan revealed over the summer — more likely than ever before to still be living at home.

The figures should change the way Canada thinks about its real estate sector, said Graham Haines, research and policy manager at the Ryerson City Building Institute in Toronto. Policymakers have focused almost exclusively on policies to promote home ownership over the last 20-plus years, he said, pointing to tax policy and incentives.

"We have to start thinking about — if rent is going to start becoming a more important part of our real estate sector once again — how we make sure we're building the right type of rental, rental where we need it and rental that's affordable for the people who are going to be using it," Haines said.

In 2016 more than 9.5 million of the 14.1 million households captured in the census owned their homes, an ownership rate of 67.8% — down from 69% in 2011 after 20 steady years of baby boomers flooding the real estate market.

Rising house prices get government to act

Since 2011, the census shows, the value of homes has steadily increased to a national average of $443,058, up from $345,182 in 2016 dollars. Vancouver had the highest prices in the country with the average home valued at over $1 million; Toronto was at $734,924 and Calgary at $527,216. Montreal came in at $366,974.

As values have climbed in cities like Toronto, Vancouver, Calgary, Edmonton and Ottawa, so too have the percentage of renters, even though the supply of purpose-built rental units nationally has been on a decades-long decline as developers build more condominiums than apartments.

Overall, affordability remains an issue for almost a quarter of Canadian households, a figure that hasn't changed much in a decade, with the pressure most acute in the hot housing markets of Toronto and Vancouver.

The federal Liberal government has promised to address affordability issues as part of an $11.2 billion, 11-year housing plan to be released in the coming weeks. It's expected to have a heavy focus on building affordable units, with a new portable housing benefit that would be tied to individuals, rather than properties.

Speaking earlier this fall about work on the strategy, Evan Siddall, head of Canada Mortgage and Housing Corp., said the focus wasn't solely on helping the ranks of homeowners.

"Rent or own, a home is a home," Siddall said in an interview.

"When we think about housing we have got to think about renters who need support to rent, renters who rent on a market basis, and make sure people can migrate and own homes who should own homes."

Millennials versus boomers

The migration to home ownership is likely to pick up for millennials in the coming years as they start families and look for homes or condominiums — a class of home that saw a 1.2% increase in households from 2011 — to fit their growing brood. At the same time, seniors will be looking to downsize.

That means the baby boomers will continue to fuel changes in the housing market by how long they remain homeowners and whether their children and grandchildren decide to rent or buy.

Haines said the two age groups, even though they are at different points in their lives, are likely to compete for the same kind of two-bedroom units that are a rarity in the market, potentially driving up costs. That may require policymakers to get more involved in the market to make sure more family-friendly housing gets built instead of a heavy focus on studios and one-bedroom units, Haines said.

"We've fallen into this trap of building [condo] units for investors rather than end users," Haines said.

"There are positive signs that we're starting to recognize that over the last 20 years, we've sort of let the market do what the market wants and maybe we need a little more attention […] that we're actually getting what we need for our population."

8. Liberals to index CCB, expand working income tax benefit

[October 24, 2017] The Trudeau government is dedicating about a third of the windfall it's expecting from the surprisingly strong economy toward investments, tax relief and new spending on social programs to support children and the working poor.

Finance Minister Bill Morneau released a fall economic statement Tuesday that promises nearly $15 billion in fresh spending over the next five years — on top of what it had outlined in its March budget.

The government focused on four major spending measures in the update:

- indexing the Canada child benefit (CCB) to cost-of-living increases,

- expanding the working income tax benefit (WITB) program,
- formalizing a promised cut to the small business tax rate and
- ongoing work to overhaul the tax code.

Morneau announced the government will introduce an enhancement to CCB payments so they start rising with the cost of living two years earlier than initially promised — at a cost to government of $5.6 billion over five years.

He will also bolster the WITB, a refundable credit aimed at providing relief for low-income Canadians who have jobs and encouraging those who don't to join the workforce. The measure is projected to lower government revenues by $2.1 billion over five years, starting in 2018.

Measures to lower the small business tax rate to 10% next year and 9% in 2019, along with ongoing overhauls to the tax code, will cost the government $1.3 billion between 2017 and 2022, but that doesn't take into account one of the major changes coming to tax rules on how passive investments are handled.

Tax proposals for small business

The government says in the report that revised draft legislative proposals for income sprinkling by private corporations will be released "later this fall."

Specifically, the government says it will introduce reasonable tests for family members aged 18 to 24, as well as for those 25 and older, for income sprinkling.

And, as announced on May 5, 2017, the government says it will also bring forward legislative proposals to ensure farmers and fishers aren't inappropriately denied the small business deduction on income from sales to a co-operative.

Spending follows strong economy

The spending measures announced today take advantage of this year's unexpectedly robust economic performance, which is projected to provide an additional $47 billion for the government's bottom line over the same five-year period.

The remaining portion will be aimed at reducing annual deficits, which are projected to shrink each year starting in 2018-19.

The government, however, did not map out a timeline to balance the federal books, even though it had promised in its 2015 election platform to do so by 2019.

9. Should Canada emulate Australia with a budget-honesty charter?

[October 24, 2017] Government budgets around the world face daunting challenges.

Many countries are now confronting at least three concerns in managing their fiscal position: They have a long-term reliance on borrowing, a difficulty in managing shocks to their economic systems and a high degree of opaqueness in the conduct of the fiscal process.

These problems seem to get worse every year, and while countries can take different approaches to tackle them, one possible approach gaining attention around the world is the enshrinement of fiscal rules and regulations.

Fiscal rules, such as debt limits and balanced-budget requirements, act as resolutions by governments to adhere to some set of budgetary directives. Sometimes, these fiscal rules are enshrined in a constitution or abiding document, which we can call a Charter of Budget Honesty.

In a broad sense, a Charter of Budget Honesty lays out the manner in which the budget system of a country, state or province should be managed. It may include suggestions for constraints and rules that encourage fiscal discipline, as well as for the general practice of preparing and presenting budget information. It may even outline the broader goals and objectives of the budget process.

The best-known among such documents is the Australian Charter of Budget Honesty. Since 1998, the charter has come to form a pillar of the country's budget process and drives its budgetary culture both in terms of belief and practice.

As Finance Minister Bill Morneau prepares to deliver a fall economic update this week to document the recent strong growth in the Canadian economy, it's a good time to ask: Could such a charter be helpful to Canada's budget process?

In a research article for the Canadian Parliamentary Review, I examined whether Australia's charter could be used in other countries, including Canada.

Using charters of budget honesty

Although nations that include New Zealand and the U.K. have passed budget acts encouraging fiscal discipline, the Australian charter has become more prominent due to its local legislative budgeting context. At the time that it was first instituted, the charter represented the very best in fiscal policy legislation, both in terms of scope and rigour.

The charter initiated a set of rituals now considered core aspects of the annual budget. Australians have come to consider them standard political and economic practice.

The purpose of the charter is “to improve fiscal policy outcomes,” and it provides for this “by requiring fiscal strategy to be based on principles of sound fiscal management and by facilitating public scrutiny of fiscal policy and performance.”

In order to meet these outcomes, the charter is comprised of several important moving parts that together build a more cohesive fiscal discipline framework. They help to increase transparency by creating a regular stream of government reports that apprise the public, Parliament and other government branches of movements in the national fiscal balance.

Limitations of these charters

Today in Australia, however, many of the country’s budget scholars seem to think that the charter’s definition is still insufficient and leaves a lot of wiggle room to interpret the abstract notion of “budget honesty.”

Among the charter’s criticisms, one of the most important is that the document invites an overproduction of fiscal data. And having too much data may be nearly as bad as none at all when it comes to restricting the ability of decision-makers to conduct oversight.

A second criticism is that such charters, or fiscal rules more generally, encourage fiscal prudence but they do not enforce it.

Additionally, there is an inherent trade-off between the flexibility of governments to act, particularly during crises, and the discipline they must exercise under the charter. Because of the high uncertainty about future economic growth, governments do want to keep some degree of flexibility to respond to changing circumstances.

Finally, there’s also an ideological problem. What is good fiscal policy?

Some political parties emphasize balanced budgets while others view the flexibility to run planned deficits as good fiscal policy. There is no final word in that debate and there may never be one.

Should Canada get a charter?

Despite the criticisms raised above, there is still reason to consider a Charter of Budget Honesty for Canada. The greatest case in favour of it comes from the fact that Australia’s public debt has remained low (private debt is a different story, and a much scarier one), for much the same period that the charter has been in place.

The charter’s underlying spirit of budget restraint, coupled with a long mining boom, has meant the Australian government today has more than enough fiscal muscle to withstand shocks. In fact, compared to almost all developed economies, Australia emerged virtually unscathed from the 2008 financial crisis.

Weathering that recession and proceeding through a "record-breaking," uninterrupted 25-year period of economic growth with a strong fiscal position is the strongest and simplest argument for considering the mechanisms that made Australia's strong fiscal architecture possible.

Given Canada's similar parliamentary government, cultural heritage and resource-dependent economy, Canada would seem a very clear candidate for transposing an Australian solution.

However, as my research has found, the suitability of a charter depends on its goal. If, on one hand, the objective is to ensure full and rigorous fiscal transparency and discipline, then such a charter, or any other budget honesty mechanism for that matter, would be an insufficient piece of legislation on its own.

If, on the other hand, the objective is to incrementally enhance Parliament's fiscal engagement and budgeting rigour as part of a broader commitment to "fiscal prudence," then a Canadian Charter of Budget Honesty could be useful.

10. Trudeau to increase per-person federal debt by 5%: Fraser Institute

[October 23, 2017] Prime Minister Justin Trudeau is on track to increase per-person federal debt more than any other prime minister who didn't face a world war or economic recession, finds a study by the Fraser Institute.

"Government debt matters — higher debt means more tax dollars are diverted away from important public programs in order to pay interest, and it leaves future generations on the hook to pay for today's spending through higher taxes," said Charles Lammam, director of fiscal studies at the Fraser Institute and co-author of the study, in a release.

In light of Canada's 150th anniversary, the study tracks the debt legacies of every Canadian prime minister since confederation: how much they increased or decreased total federal debt (which includes all federal financial liabilities) during their time in office, after accounting for both inflation and population changes.

The study found, based on the Liberal government's projections, that Trudeau will increase per-person federal debt by 5% from 2015 to 2019 — the largest increase of any prime minister whose time in office didn't include a world war or economic recession.

Other Liberal prime ministers Jean Chrétien, Paul Martin and Lester B. Pearson all managed to cut per-person debt, the think tank reported: Chrétien by 13%, Martin by 8% and Pearson by 6%.

Only two other prime ministers increased per-person federal debt during their tenure while not presiding over a world war or recession: John Abbott and Mackenzie Bowell, both of whom served in the late 19th century.
Among all Canadian prime ministers, Robert Borden, who governed during the First World War and four years of economic downturns, increased per-person debt levels the most (188%). Louis St. Laurent lowered the federal per-person debt the most (34%), even though his tenure included two recessions.

Have a nice and fruitful week!