Weekly Updates Issue # 648

1. Weekly Markets Changes
2. Ottawa rings up $9.1-billion deficit for first 8 months of fiscal year
3. CPI data point to ‘hotter price growth’ for Canada: economist
4. ECB’s Draghi warns against U.S. talking down dollar
5. Last chance for family loans: prescribed rates to rise April 1
6. What’s new or changed for 2017 tax-filing season
7. Canada agrees to revised TPP trade deal without U.S.
8. Are we headed for another global financial crisis?
9. Minimum wage increases trickle upward

1. Weekly Markets Changes

[January 26, 2018]

S&P TSX	S&P 500	Dow Jones	NASDAQ	CAD/USD	Gold	WTI Crude
16,239.22 -114.24 -0.70%	2,872.87 +62.57 +2.23%	26,616.71 +544.8 +2.09%	7,505.77 +169.4 +2.31%	$0.8116 +0.90c +1.12%	$1,349.12 +17.28 +1.30%	$66.14 +2.77 +4.37%

2. Ottawa rings up $9.1-billion deficit for first 8 months of fiscal year

[January 26, 2018] The federal government’s deficit for the first eight months of the current fiscal year was smaller than a year earlier as revenue growth outpaced increases in spending.

According to the latest fiscal monitor, Ottawa rang up a deficit of $9.1 billion for the period from April to November, compared with a shortfall of $12.7 billion in the same months of the previous fiscal year.

The monthly report says revenues were up $8.8 billion, or 4.8%, as an increase in tax revenues was partially offset by a decrease in employment insurance premium revenues.

Program spending increased by $5.8 billion, or 3.2%, reflecting increases in major transfers to persons and other levels of government and direct program expenses.

Public debt charges were down $500 million, or 3%, largely due to a lower average effective interest rate.

The government’s fall economic update projected a spending shortfall of $18.4 billion for the financial year ending March 31, down from the $25.5 billion deficit projection in the March budget.

3. CPI data point to ‘hotter price growth’ for Canada: economist

[January 26, 2018] The annual pace of inflation slowed in December compared with November as gains in the price of gasoline eased up, Statistics Canada said Friday.

The agency said the consumer price index for the final month of 2017 was up 1.9% compared with the same month a year earlier. That compared with a reading of 2.1% in November. Excluding gasoline, prices were up 1.5% on an annual basis in December, matching the increase in November.

Brian DePratto, senior economist for TD Economics, suggests looking past the pullback in the annual pace of inflation, in his commentary. “Looking past the energy-led deceleration in inflation,” he says, “hot growth of the Canadian economy in 2017 now appears to be turning into somewhat hotter price growth.”

He predicts the Bank of Canada will likely be comforted by both its decision to hike rates earlier this month as well as the fact that “the growth-inflation nexus remains intact […].”

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He predicts the Bank of Canada will likely be comforted by both its decision to hike rates earlier this month as well as the fact that “the growth-inflation nexus remains intact […].”

“Risks and uncertainty may result in increased caution, but, ultimately, achieving the inflation control target will require further monetary tightening,” says DePratto. “We remain of the view that the balance of risks versus fundamentals favours the next rate hike falling in July.”

In a research note, CIBC’s Nick Exarhos also says he isn’t fazed by either the headline drop in inflation or the dip in the annual rate. “Two out of three core metrics edged higher on the month, and have—on average—closed the gap with the Bank of Canada’s 2% target,” he explains.

The details

Prices were up in seven of the eight major categories as the transportation index, which includes gasoline, and the shelter group led the way.

Transportation prices were up 4.9% from a year ago compared with a 5.9% increase in November. Gasoline, a key component of the group, climbed 12.2% compared with a year earlier following a 19.6% increase in November.

The shelter index climbed 1.4% compared with a year ago as natural gas prices rose 6.2% following a 3.1% increase in November.

Meanwhile, the household operations, furnishings and equipment index fell 0.3% compared with a year ago as the cost of telephone services slipped 5%.

Two of the Bank of Canada's three preferred measures of core inflation, designed to look through the noise of more volatile items like gasoline, ticked higher last month.

CPI-trim—which helps filter out extreme price changes—rose to 1.9% from 1.8% in November, while CPI-common, which filters out prices that changed due to extraordinary circumstances, climbed to 1.6% from 1.5%. CPI-median was unchanged compared with November at 1.9%.

The Bank of Canada raised its key interest target last week by a quarter of a percentage point to 1.25%.

The central bank aims to keep inflation at 2%, the midpoint of a target range of 1% to 3% over the medium term.

In raising its trendsetting rate, the Bank of Canada pointed to unexpectedly solid economic data as key drivers behind the decision. It was the third rate increase since last summer.

4. ECB's Draghi warns against U.S. talking down dollar

[January 25, 2018] Europe's top economic official has cautioned the U.S. and Treasury Secretary, Steven Mnuchin, about talking down the dollar's exchange rate. This would help U.S. exporters but could make life harder for Europe and other trade partners.

European Central Bank President Mario Draghi didn't mention Mnuchin by name but was quick to note Thursday that global leaders had agreed for years that "we will refrain from competitive devaluations."

Draghi's swipe came after Mnuchin said this week that "obviously a weaker dollar is good for us as it relates to trade and opportunities." Those remarks broke with a 20-year U.S. policy of speaking in favour of a strong dollar.

Such comments matter because a weaker dollar can help U.S. exporters by making their goods cheaper against foreign competition.

But it’s a zero-sum game: a fall in the dollar means a rise in a corresponding currency—the euro rose to a three-year high of $1.25 upon Mnuchin’s remarks. The higher euro can become a headache for Europe as it can hurt its exporters and weigh on inflation, which is already worryingly low.

In his comments on Thursday, Draghi cited the repeated joint statements by international finance officials in which they commit to refrain from lowering their currencies’ exchange rates to gain trade advantage at the expense of other countries.

Draghi added that recent swings in the euro exchange rate with the dollar—mostly up in the past few days—were “a potential source of instability” that required “monitoring.” Draghi noted that the exchange rate wasn’t a policy goal for the ECB but had to be considered in its deliberations about what to do about inflation.

Exchange rates are determined by many factors, including trade flows and central bank policies. Rates these days are not set by governments but by global foreign exchange markets where major currencies are bought and sold. Official comments can, however, have an impact.

One risk, however, is that other countries might retaliate by taking measures that lower their currency.

“The ECB refrained from aggressively pushing back against the strength of the euro at their monetary policy decision […] but also warned the U.S. against opening a Pandora’s box of competitive devaluation,” said William Adams, senior international economist at the PNC Financial Services Group. “Put simply, Draghi is warning that foreign countries could follow the U.S. in a race to the bottom if the U.S. tries to devalue the dollar.”

ECB leaves interest rates unchanged

Draghi made his comments at a news conference following a decision by the bank’s 25-member governing council to leave its stimulus programs and interest rates unchanged. The bank gave little additional hint about whether its 30 billion euros (US$36 billion) in monthly bond purchases would run past September.

Currently, the bank says the purchases will continue at least through September and longer if necessary, leaving the exact end open. The purchases pump newly created money into the economy to raise inflation and growth in the wake of the 19-country Eurozone’s crisis over high debt in member states like Italy and Greece.

Stimulus withdrawal has been much discussed in markets because the Eurozone economy is growing strongly. Germany’s Ifo index of business sentiment matched its record high in January, and surveys show business activity is expanding rapidly.

The Eurozone is expected to have grown 2.4% last year, while unemployment has fallen to 8.7% from a high of 12% in 2013.

The bank left its key short-term interest rate benchmark unchanged at a record low of zero. Its rate of minus 0.4% on deposits it takes from commercial banks was also unchanged. The negative rate is a penalty aimed at pushing banks to lend the money rather than let it pile up risk-free at the ECB.

5. Last chance for family loans: prescribed rates to rise April 1

[January 25, 2018] There are only a few months left to take advantage of low prescribed interest rates for income splitting and other loans: the rate will double April 1, experts say.

Bank of Canada interest rate hikes, which have already prompted banks to raise their lending rates, will mean CRA's prescribed rate will go from 1% to 2% in the second quarter, says Jamie Golombek, managing director for Tax and Estate Planning at CIBC Financial Planning and Advice.

And with most economists predicting further hikes in 2018, "we could be stuck at the 2% rate for many months, if not years," Golombek tells Advisor.ca. Or the prescribed rate could go even higher.

Prescribed rate loans can be used to split investment income with a spouse or common-law partner with lower income. One partner in the highest tax bracket, for example, can loan money to the partner in the lower bracket to invest, with the dividends taxed at the lower bracket.

"The advice that we're giving now is that if you've always thought about doing a prescribed rate loan, you need to act by March 31 to lock in the 1% rate," says Golombek, who wrote about the implications in detail here. Otherwise, clients are "basically doubling the cost of the interest expense that the lower-income spouse or partner is paying to the higher-income spouse or partner."

The prescribed rate is determined quarterly by a formula in the Income Tax Regulations that calculates the average of three-month Government of Canada Treasury yields for the first month of the preceding quarter. The formula rounds up to the next highest whole percentage point.

For the second quarter, beginning April 1, the calculation is based on January. Those yields were 1.17% on Jan. 9 and 1.2% on Jan. 23, making an average of 1.185% that will be rounded up to 2%, says Golombek. (Analysis by Kyle Westhaver and John Nicola, published Friday on Advisor.ca, draws the same conclusion.)

CRA will officially announce the prescribed rate for Q2 in March, typically on the 15th. It will be the first increase since the prescribed rate dropped to 1% at the start of 2014.

In addition to spousal loans, prescribed rate loans used to help fund trusts such as family trusts may be impacted, says Curtis Davis, senior consultant for tax, retirement and estate planning services at Manulife. Family trusts can be used for expenses including children's private school tuition, he says.

Those using home purchase loans, home relocation loans and shareholder loans may also be impacted, he says.

The rate is also used in employee loans.

"An increase in the prescribed rate could affect the personal cash flow required to service the interest and, potentially, the tax benefit" of employee loans, wrote Doug Carroll, practice lead for tax, estate and financial planning at Meridian, in November.

Ensure clients structure prescribed rate loans properly. Interest payments for a given year are due no later than January 30 of the following year. A missed payment means income is thereafter taxed in the lender's hands, as if the arrangement had never been made.

The loan should go from an account in one partner's name to an account in a different name, rather than using a joint account. "Then you have to start proving whose money is it," Golombek says.

The lender must also declare interest income.

More changes to come?

After the federal government's controversial reforms to small business tax rules announced last year, the industry is waiting for the 2018 budget to see if more changes are coming. Golombek says he doesn't foresee anything that would impact the rules around spousal loans.

"I don't think a 2% rate is below market, so I don't think there's anything abusive here. That being said, we know the government has been targeting income splitting through private corporations," he says.

"I don't think it's particularly at risk–although, you never know."

6. What's new or changed for 2017 tax-filing season

[January 24, 2018]

Changed credits and amounts

- **Tuition, education and textbook credits**. As of Jan. 1, 2017, the federal education and textbook credits were eliminated. However, you can still carry forward unused amounts from previous years. Also, with certain conditions, you may now be able to claim the tuition amount for fees paid to a post-secondary educational institution for occupational skills courses, even if you're not at a post-secondary level.

- **Children's credits.** As of Jan. 1, 2017, the children's arts tax credit and children's fitness tax credit were eliminated.
- **Public transit tax credit.** As of July 1, 2017, this credit was eliminated. For the 2017 tax year, you can claim the cost of eligible public transit expenses only for travel taken from Jan. 1 to June 30, 2017.

New and improved credits

- **Canada caregiver credit.** This non-refundable tax credit replaces three separate credits: the family caregiver credit; the credit for infirm dependants age 18 or older; and the caregiver credit. The new credit gives tax relief to eligible individuals who have a spouse or common-law partner, or a dependant, with a physical or mental impairment.
- **Disability tax credit (DTC)** certification. Nurse practitioners across Canada can now certify the DTC application form.
- **Medical expense tax credit.** If you need medical intervention to conceive a child, you may be eligible to claim certain expenses even if you don't have a medical condition—these expenses are the same as those that would generally be allowable for individuals who have a medical condition. If you have had fertility-related expenses for any of the 10 previous calendar years and haven't claimed them, you can request a change to their income tax and benefit returns to include these eligible expenses.

New services

- **Mailing a paper income tax and benefit return to homes**. Starting this year, the CRA will mail a 2017 income tax and benefits guide and forms book to paper filers. For those who want to file on paper and haven't received a guide and forms book by Feb. 26, 2018, they can find what they need online or order a paper copy.
- **Phone filing with File my return.** This automated service lets eligible Canadians with simple tax situations file their return by answering a few questions.
- **Viewing transactions and paying balances with CRA BizApp.** This app lets small businesses and sole proprietors view their business account balances and make payments by pre-authorized debit to their corporations, goods and services tax/harmonized sales tax (GST/HST), payroll, and excise duty accounts.

7. Canada agrees to revised TPP trade deal without U.S.

[January 23, 2018] Canada and the remaining members of the old Trans-Pacific Partnership agreed today to a revised trade agreement that will forge ahead without the U.S., opening distant new markets at a time of uncertainty closer to home.

The deal comes exactly one year after U.S. President Donald Trump withdrew his country from the agreement, leaving Japan as the largest player in a new 11-country pact that spans two hemispheres and includes the U.S.'s neighbours.

Asked by reporters whether he was aware of the deal, Prime Minister Justin Trudeau said while walking past them at the Davos economic summit: "Who do you think has been working hard at it behind the scenes."

The agreement follows two days of high-level talks in Tokyo and was confirmed by a spokesman for International Trade Minister Francois-Philippe Champagne. The partners are now expected to work toward signing the agreement by early March.

The announcement came just hours after a Canadian government official told The Canadian Press that Ottawa believed a deal could be struck, even as it pushed for more progress on negotiations surrounding the automotive and cultural sectors.

Another Canadian government official says Champagne pressed his counterparts for an exemption on culture-related elements that had been part of the original deal with nearly a dozen Pacific countries.

The official says Canada will protect its cultural sector in the updated deal through legally binding side letters with each partner.

More details

In the auto sector, which is considered key to the deal, Canada managed to get a bilateral arrangement with Japan to resolve non-tariff barriers, including a binding dispute settlement mechanism, according to an official. The official also says that a bilateral agreement with Malaysia to adjust auto rules-of-origin was reached, and another one was being finalized with Australia.

But a major Canadian auto-parts association offered a scathing reaction.

Flavio Volpe of the Auto Parts Manufacturers' Association says this agreement moves Canada in the exact opposite direction of where its most important customer and powerful next-door neighbour is headed — right in the midst of sensitive negotiations.

He adds the U.S. is pushing for a new NAFTA that increases domestic content requirements, and keeps Chinese parts out of North America, but the revamped TPP deal moves Canada and Mexico the opposite way, reducing

local requirements and letting more product from non-TPP countries like China into the supply chain.
“This could not be a dumber move at a more important time,” Volpe says in an interview.
He accuses Champagne of chasing a legacy item, without regard for how it might affect the far more important NAFTA negotiations — literally unfolding this week in Montreal: “We’re trophy hunting,” Volpe says.
Canada, the second-largest economy among the partners, was widely considered the main holdout in the negotiations. Last fall, the pact was rebranded the Comprehensive and Progressive Agreement for Trans-Pacific Partnership.
The Tokyo negotiations were the first high-level talks since the leaders of the partner economies met in November on the sidelines of the Asia-Pacific Economic Co-operation summit in Danang, Vietnam.
Trudeau made international headlines there by deciding not to sign an agreement-in-principle on what became known as TPP11 following the U.S. withdrawal. Trudeau’s decision in Vietnam to continue negotiating for a better deal, rather than striking an agreement, led to the abrupt cancellation of a TPP leaders’ meeting in Danang.
Volpe adds Canada has now caved into countries that really wanted a deal, without extracting much new in return. He notes that trade with these countries pales in comparison with the U.S.: “New Zealand,” he says sarcastically, naming one TPP country: “That huge market we’ve been waiting our entire lives to crack.”
Many believed the original TPP had suffered a fatal blow when Trump withdrew from the deal in his first week as president.
The government official says Trudeau had been bringing up the Asia-Pacific trade pact in recent months every time he’s had conversations with leaders from the other partner economies. Over the last week, he discussed the deal with the leaders of New Zealand and Chile by phone.
Trudeau also dispatched well-connected Vancouver Economic Commission chief executive Ian McKay as his personal envoy at this week’s negotiations in Japan, the official says. McKay joined Canada’s chief and deputy chief negotiators in Tokyo for two days of talks that were scheduled to wrap up Tuesday.
Besides Canada, the new deal’s partners are Australia, Brunei, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, and Vietnam.
Most importantly, the deal will open up access for Canada to Japan’s economy, the third-largest in the world. Canada’s agricultural, seafood and forestry sectors would see some of the greatest benefits, the official said.

The official insists that Champagne and Foreign Affairs Minister Chrystia Freeland also remained engaged with their counterparts in recent months.
They add that Trudeau's principal secretary, Gerald Butts, met with Japan's ambassador last week to discuss the deal.

8. Are we headed for another global financial crisis?

[January 23, 2018] Fears have risen recently that the global economy may be heading for another downturn, with many worried about the scale of gains in global stock markets and the huge volatility in trading of virtual currencies like Bitcoin.
But experts at the World Economic Forum in Davos, Switzerland have yet to come to a consensus on whether we're headed for another global crisis.

What could cause it?

A leading British investment manager says that a catastrophic IT crash that puts markets out of action for several days could be the catalyst to another financial crisis.
Anna Richards, chief executive of London-based M&G Investments, says the next financial crisis is unlikely to emerge from a geopolitical event, as markets are used to dealing with such events on a regular basis.
More worrying for Richards are the technological innovations that have fundamentally altered the way markets operate and that investors are "somewhat blind to."
She says, "We all have businesses which are absolutely reliant on a very small number of people who provide the pipes that effectively we all put our business though."
How markets react if no one could trade for "one, two or three days" would be "kind of interesting," she adds.
And since stock markets around the world are flying high amid a synchronized global upturn, a leading U.S. investor is warning of a potential "reckoning."
Stephen Schwarzman, chairman and CEO of Blackstone, notes the markets have responded to a positive global economic growth story. It is, he says, a time of "enormous ebullience."
However, he says there are "lurking" geopolitical risks that could knock markets off track and there will come a time when some of these problems are "not contained."
U.S. stock markets have been particularly strong, with the Dow Jones industrial average on a run of record highs on the back of confidence around the U.S. economy and President Donald Trump's tax reform package.

No downturn yet

Meanwhile, one expert on global financial crises is downplaying fears that the world is set for another downturn.

A decade on from the last crash, professor Kenneth Rogoff from Harvard University says there is "no plan A" to deal with another crisis given that interest rates remain at super-low levels and public finances remain stretched.

However, Rogoff said at the World Economic Forum that financial crises have a "long afterlife" and that "we're actually at the tail-end of the last one."

Still, he says China is the country that's exhibiting many of the characteristics of a "typical financial crisis building up."

9. Minimum wage increases trickle upward

[January 22, 2018] There's been plenty of good news about economic growth, both in Canada and globally. Observing that macro trend naturally results in micro musings. Specifically, when are we all getting a raise?

Certainly, some minimum-wage workers already have more money in their pockets—and that's trickling up to higher earners in some cases.

Stories from the trenches

Nick Cluley and his wife, who have always paid their Coffee Public employees more than minimum wage, have boosted everyone's pay by $1.25 an hour since Jan. 1—not just those earning below $14, as a new Ontario law required.

They did that "to avoid tensions that might come from more experienced people, you know, being crunched right up against the same salary as someone that just started," he said.

The new starting wage is $14.75, though the staff average is closer to $15.45, he said, adding they raised prices by about 10% on everything they serve in their Toronto and Port Hope, Ont., shops.

From small mom-and-pop shops to a discount retail giant, there are already examples of companies that have bumped the hourly pay for employees who were making close to the new $14 an hour minimum—suggesting Ontario's recent minimum wage hike is affecting more than just the lowest paid workers.

There's little question that a minimum wage hike in Ontario will have a "trickle up" effect to raise wages for other workers, said Bernard Wolf, a professor emeritus at York University's Schulich School of Business in Toronto.

"The question is simply how much and how pervasive that is," he said, adding it's likely a considerable number of employers in Ontario—where the minimum wage rose to $14 on Jan. 1, 2018—will make such a move.

That ripple effect through the economy comes as employees who find minimum wage has now risen close to what they're earning ask for raises to reflect their comparative skill level, Wolf said, or because their cost-of-living has increased as the price of goods goes up to offset the higher labour cost.

For employers already making the move, they benefit from positioning themselves as the good guy compared to other companies that raised the ire of consumers for clawing back employee benefits and other perks instead, he said.

Union Local 613 co-owner Ivan Gedz raised wages for all his kitchen staff to $16 in November, after realizing his Ottawa eatery could not only meet the new minimum in January, but surpass it.

The raises, which amount to between 50 cents and as much as $4 per hour depending on the employee, reflect Gedz's belief in equality and because he realized the situation presented an opportunity to be an industry leader, he said. He raised prices on some items to offset the hit to his bottom line.

Small businesses aren't the only ones setting a higher bar.

Walmart Canada, which employs more than 95,000 associates, increased its starting minimum wage on Dec. 23, 2017 just ahead of the Ontario-wide hike, said spokeswoman Anika Malik, adding all the company's associates earn more than the provincial minimum wage.

"All pay bands also moved up accordingly to maintain appropriate relative compensation at all levels," she said. The company isn't cutting any roles, and employees will still be eligible for bonuses and performance increases, Malik said.

Meanwhile, one coffee chain has applied the pay increase to more than just their Ontario-based employees.

JJ Bean Coffee Roasters, which has more than a dozen locations across Toronto and Vancouver, first increased wages in Toronto on Dec. 17, 2017, and followed suit in Vancouver on Jan. 14, 2018, according to a letter from its senior leadership team.

Its national starting wage is now $14 an hour, and it increased wages for all employees making below $20 hourly. The company increased prices at its cafes by 1% to 3%.

"We believe people have intrinsic value and that everyone who takes part in the journey of coffee—from farmers to baristas—deserves to be fairly rewarded for their work," the letter reads.

Wage pressures still mild

Despite these stories, wage and price pressures have yet to rear their heads in economic data.

In a weekly economics report, BMO chief economist Douglas Porter notes this lack of pressure even in the face of a tight job market. (A lack of wage and price pressures makes up part of his checklist to indicate that the economic cycle still has plenty of room to run.)

“No doubt, the industrialized world is fast running into real labour shortages, but this is assuredly not pushing up wages in a big way; instead, it’s prompting an even swifter shift to automation,” he says.

Further, employment rates in the U.S. and Europe can still drop further, so “there’s still room to grow,” he says.

Workers might be waiting for higher wages, but at least the tight labour market isn’t making them wait for jobs—at least in some industries. Porter says that, on a recent panel, the COO of a large Canadian steelmaker revealed the company’s biggest challenge: finding workers.

Have a nice and fruitful week!

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