Weekly Updates Issue # 652

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1. Weekly Markets Changes

[February 23, 2018]

S&P TSX	S&P 500	Dow Jones	NASDAQ	CAD/USD	Gold	WTI Crude
15,638.45 +185.8 +1.20%	2,747.30 +15.08 +0.55%	25,309.99 +90.61 +0.36%	7,337.39 +97.92 +1.35%	$0.7894 -0.80c -1.00%	$1,328.70 -18.25 -1.35%	$63.55 +1.87 +3.03%

2. Canada's underlying inflation rate heating up

[February 23, 2018] The annual pace of inflation cooled to 1.7% last month—but rising prices underneath the turbulence of this headline number suggest the Bank of Canada is unlikely to veer from its interest-rate hiking path.

A new Statistics Canada report Friday showed that the average of three measures of core inflation, designed to filter out the noise of more-volatile items like gasoline, advanced once again in January to hit 1.8%.

The average of the core readings reached its highest mark since September 2016, the latest consumer price index found.

"You wouldn't know it from the headline number, but Canadian inflationary pressures are heating up," said Royce Mendes, director and senior economist for CIBC World Markets, in a research note on Friday.

Still, he predicts the Bank of Canada will be patient with rate hikes. "[…] Even if inflation reaches target and the labour market is running at full employment later in the year, central bankers will still have reason to leave some stimulus in place given that the economy is facing a number of potential headwinds," he says.

Average core inflation has been on a steady monthly climb since it fell to 1.3% in May 2017. The movement suggests underlying consumer prices have been moving higher due to Canada's recent economic strength.

As such, the upward momentum of underlying prices will at least catch the attention of the inflation-targeting Bank of Canada, which has said its ideal inflation bull's-eye is 2%.

The reading likely reinforces expectations that the central bank will continue raising its trend-setting interest rate, which governor Stephen Poloz has already hiked three times since last summer.

The Bank's next rate announcement is scheduled for March 7, and it has repeatedly stressed it will remain data dependent when considering future rate decisions.

Overall, Statistics Canada's headline inflation reading of 1.7% for January was weaker compared to a 1.9% result in December and 2.1% in November.

The federal agency said the main downward forces on inflation last month were due to cheaper prices for video and digital equipment, electricity and travel tours.

The report said the primary upward pressure on inflation was driven by higher costs for air transportation, gasoline and restaurants.

Those pricier meals away from home helped propel food prices 2.3% higher than they were a year earlier—for the biggest increase in the reading since April 2016.

Year-over-year gas prices were up 7.8% last month after a 12.2% gain in December.

By region, Statistics Canada found that consumer prices rose at a slower annual pace last month in eight of the 10 provinces. Only British Columbia, with 2.1% inflation, and Ontario, with 1.8% inflation, saw bigger year-over-year price increases.

January inflation breakdown, by province

- Newfoundland and Labrador: 1.1%, compared to 1.7% in December
- Prince Edward Island: 1.6%, compared to 2%
- Nova Scotia: 1.4%, compared to 1.7%
- New Brunswick: 1.8%, compared to 2.9%
- Quebec: 1.3%, compared to 1.8%
- Ontario: 1.8%, compared to 1.5%
- Manitoba: 2.1%, compared to 2.9%
- Saskatchewan: 2.5%, compared to 3.4%
- Alberta: 1.4%, compared to 2%
- British Columbia: 2.1%, compared to 2%

3. C.D. Howe calls for end of small biz deduction in shadow budget

[February 23, 2018] n its 2018 budget, the federal government should respond to lower U.S. corporate tax rates by accelerating write-offs of business investment, argues the C.D. Howe Institute.
In its shadow budget released Thursday, the think tank also calls for removing the small business deduction, phasing out certain tax credits, reducing personal tax rates and various changes to bolster retirement-savings programs. The federal government will table its 2018 budget on Feb. 27.

Here are some of the proposals in "Righting the Course: A Shadow Federal Budget for 2018."

- **Faster expensing of capital investments:** eliminating the "half-year rule" and the "available-for-use" requirement would allow businesses to claim larger deductions faster.
- **Scrutinize tax credits and deductions that are "spending programs in disguise":** the budget proposes reducing the base amount for age credit to $4,000, phasing out the first-time home buyers tax credit, and eliminating the labour-sponsored venture capital corporations (LSVCC).
- **Reduce "punitive" personal income tax rates:** between provinces raising rates on high earners and the feds' recent four-percentage-point hike on taxable income above $200,000, the combined federal/provincial top tax rate in 2017 is hovering around, or exceeding, the 50% mark across the country. This leads to taxpayers "trying to realize their income in different forms, at different times and in different jurisdictions," and to less entrepreneurial activity over time, the think tank argues. It proposes doubling the threshold for the highest tax rate to $411,684, up from the current $205,842.
- **Transition away from the small business deduction:** the deduction, which produces a lower tax rate for small firms, expands the small business sector at the expense of large firms, the budget says. "At the same time, the Small Business Deduction may encourage self-employed individuals to incorporate in order to access the lower tax rate," says the budget. "Business owners using small private corporations to engage in personal income tax planning was the focus of last year's debate and anti-avoidance policies adopted by the federal government." C.D. Howe proposes providing the Small Business Deduction "for young, growth-oriented firms rather than simply all businesses that are small" to mitigate disincentives for growth. The alternative proposal is to allow immediate expensing of capital investments up to $200,000 for tax purposes in order to target the

preferential small business tax rate to "businesses pursuing growth-oriented strategies. It would have the additional advantage of benefiting growing small companies, rather than private corporations whose main purpose is to reduce personal income taxes on business income."

- **Extend favourable tax treatment to donations of private company shares and real estate:** the budget proposes amending the Income Tax Act provisions for donating privately held securities. It would exclude the entire disposition from tax, and partially exclude the disposition of real estate when those assets are donated to charity.
- **Level the field for group RRSPs:** DC pension plans and pooled registered pension plans help their participants prepare for retirement by allowing sponsors to deduct some administrative expenses from outside income. Participants in group RRSPs pay these expenses from plan assets. The budget proposes "to let group RRSP sponsors and/or participants deduct some administrative expenses, currently levied against plan assets, from outside income."
- **Increase age limits for tax-deferred saving:** C.D Howe proposes increasing the age at which contributions to tax-deferred retirement saving schemes must end to 72 on January 1, 2019, and adjusting the contribution time frame by one month every six months, after that date. "Among other advantages, this change should encourage older Canadians to stay in the workforce longer," the budget says.
- **Raise eligibility age for public pension benefits:** the budget proposes adjusting the Canadian age of eligibility for the CPP and OAS with life expectancy. "For Canadian demographics, that constant proportion is 34%, which would trigger an increase in the age of eligibility from 65 to 66 in 2025, phased in from the beginning of 2023," the budget says.
- **Increase tax-deferred saving limits:** "The current rules for calculating equivalency between DB and DC pension plans or limits for RRSPs are badly out of date, putting people with DC plans and/or RRSPs at a major disadvantage relative to those in DB plans," the budget says. It recommends updating the assumptions underlying the equivalency factor (Factor of Nine) "to reflect current economic and demographic realities." This would increase the tax-deferred savings limit for capital accumulation plans from 18% of income to 30%.
- **Eliminate mandatory drawdowns from RRIFs:** Low yields on safe investments and longer life spans means there is still risk of Canadians outliving their savings, even after the 2015 federal budget's reduction of mandatory minimum withdrawals. The budget recommends a

consultation on two options: "more regular adjustments to keep the withdrawals aligned with returns and longevity; or eliminating minimum withdrawals entirely."

- **Extend eligibility for pension credit and income splitting:** the budget would allow the use of credit or income splitting for life-income funds, RRIFs and RRSPs before age 65.
- **Increase GST for transportation fuels to 10%:** the budget would also eliminate aviation fuel taxes and instead charge them at this rate.
- **Lower the threshold for the medical expense tax credit:** the current medical expense tax credit only applies to expenses exceeding 3% of net income or $2,306 (whichever is lower), and is calculated at the bottom tax rate. The budget would lower the threshold to 1.5% of net income or $1,150, whichever is lower.
- **Amend the Excise Tax Act to cover digital goods and services:** C.D Howe proposes amending the Excise Tax Act to apply to businesses that supply digital goods and services, such as streaming, for consumption within Canada, regardless of where the company is located. This would level the playing field between foreign and domestic providers (which must charge GST/HST on their sales), it adds.

Progressive think tank the Canadian Centre for Policy Alternatives also released an alternative budget this week with recommendations for the Liberal government.

4. The story behind Canada's December retail slump

[February 22, 2018] Statistics Canada says retail sales fell 0.8% in December to $49.6 billion, as gains in new car sales were more than offset by lower sales at electronics and appliance stores and general merchandise retailers.

Sales at general merchandise stores fell 5.3% in December while health and personal care stores dropped 3.8%.

Electronics and appliance stores were down 9.1% in the month, following a 12.7% increase in November when sales were boosted by Black Friday sales and new product releases.

Meanwhile, motor vehicle and parts dealers posted a 2.1% increase in December, boosted by a 2.9% increase at new car dealers.

Excluding motor vehicle and parts dealers, retail sales dropped 1.8%.

Economists had expected an overall increase of 0.2% and 0.3%, excluding autos, according to Thomson Reuters.

Derek Holt, vice-president of Scotiabank Economics, blamed the numbers on increased November shopping and bad December weather.
"I can't reconcile the widespread weakness in this report with the rest of the underlying fundamentals influencing the Canadian consumer that saw a massive acceleration of job gains into year-end and strong income growth," he wrote in a research note.
"Overall, I would think the BoC cautiously looks through this report," Holt wrote.
Holt's model-based tracking estimate for December GDP is somewhere between no growth and 0.1% growth month over month. "I would still think that the risks are skewed to growth falling short of BoC expectations for next Friday's Q4 GDP growth," he wrote.
Andrew Grantham, senior economist at CIBC Capital Markets, also attributed the "deep freeze" in December retail to Black Friday pulling more shopping to November.
"That is something the seasonal factors and consensus expectations haven't caught onto yet," he wrote in a research note. "However, averaging November and December together, sales were slightly lower over the period, and the December result will still weigh on expectations for monthly GDP and BoC policy tightening."

5. CPP hikes to cost four times more than feds project: CFIB

[February 21, 2018] Ahead of next week's federal budget, the Canadian Federation of Independent Business (CFIB) is highlighting policy-induced labour costs for Canadians businesses.
In particular, Canada Pension Plan (CPP) increases will have a greater impact on jobs than the federal government projects, argues CFIB in an analysis report.
Starting in 2019, CPP premiums will rise for five straight years, followed by another two years where the maximum amount of income on which CPP premiums are levied will increase.
The CFIB study, done through the University of Toronto's Policy and Economic Analysis Program, finds that the CPP hikes will initially cost 64,000 jobs—four-and-a-half times greater than the federal government's projection of job losses.
"Employers will naturally respond to increased labour costs by looking for ways to streamline their labour needs, by adding new technologies or focusing hiring on higher-skill workers," says Ted Mallett, CFIB chief economist, in a

release. “The result is that lower skilled—generally younger workers or new Canadians—are likely once again holding the short end of the employment stick.”

Mallet further says that the CPP debate focused too much on employers not paying enough for employees’ retirements, and not enough on “finding the best savings model to meet Canadians’ needs.”

Also in the release, Dan Kelly, CFIB president, expresses concern for Canadian businesses: “The CPP hikes mark the latest cost increases to Canadian businesses that have already seen Employment Insurance (EI) premium increases, minimum wage hikes and other regulatory costs added to their books over the last year.”

CFIB’s analysis further shows that negative job impacts will last until the late 2020s, after which the impacts transform into constrained wage growth and higher government deficits.

6. New TPP deal could hurt NAFTA negotiations, auto sector says

[February 21, 2018] American imports into Canada could fall by $3.3 billion under the recently rebooted Trans-Pacific Partnership, the federal government has concluded, sparking fears the new pact could hurt the ongoing NAFTA renegotiation.

The text of the 11-country Pacific Rim trade deal—a pact President Donald Trump pulled the United States out of last year—was released late Tuesday, but a Global Affairs Canada analysis of the deal also delves into the impact on the North American Free Trade Agreement talks, which are to resume in five days in Mexico City.

The Trump administration has blasted trade deficits with Canada as an underlying reason for wanting to renegotiate or tear up NAFTA. The Canadian government rejects that position, saying the statistics don’t back the U.S. deficit assertions.

But the most recent analysis of the new TPP—known by the acronym CPTPP—predicts lower U.S. imports into Canada.

“Under the CPTPP, Canadian exports to the United States are not expected to change significantly as the United States is not party to the CPTPP. However, there would be a decline in imports by Canada from the United States, resulting from erosion of U.S.’s NAFTA preferences in the Canadian market,” the analysis says.

“Total Canadian imports from the United States are projected to fall by $3.3 billion, led by a decline in automotive products imports.”

Flavio Volpe, the president of Canada's Automotive Parts Manufacturers Association, says that will hurt Canada at the upcoming NAFTA round, where auto remains a major obstacle between Canada and the U.S.

"The report states that U.S. imports into Canada would drop $3.3 billion, mainly in automotive. If true, that is a gap that smart U.S. negotiators could then be seeking to close in NAFTA 2.0," said Volpe.

Canadian auto workers and manufacturers have been critical of the new TPP, including the government's assertion that it has gained more access to the protected Japanese market.

International Trade Minister Francois-Philippe Champagne has said a side letter with Japan guarantees greater access and enshrines a dispute resolution mechanism. But that side letter and others with Malaysia and Australia have yet to be made public.

The government's analysis also says, "production in the automotive sector is expected to rise very modestly, by $206 million."

The analysis concludes: "The impacts on the automotive sector are slight, with a small increase in output and exports."

Volpe dismissed those predicted gains as insignificant. He said the gain would amount to only $171 million by 2040.

"Contextually, the Canadian auto sector ships about $85 billion in goods annually. This 22-year increase represents approximately 0.2% on that number and when one accounts for inflationary dynamics, this represents a serious decline in real dollars."

The government analysis also concluded that the agreement would generate long-term economic gains for Canada totalling $4.2 billion, up from the $3.4 billion that was expected under the old TPP. The increase is due to improved access to member nations in the absence of U.S. competition.

Champagne said now that the full text of the 11-nation trade pact has been released, it will be signed March 8 in Chile.

The analysis suggests that the net benefits are greater for Canada now that the United States has withdrawn from the agreement.

The destiny of the trade pact was cast into doubt late last year after Trump pulled the U.S. out. But Canada and the remaining members of the old TPP agreed to a revised trade agreement on Jan. 23 that would forge ahead without the U.S.

The U.S. pullout left Japan as the largest player in the revised 11-nation pact that spans two hemispheres and includes both U.S. neighbours.

"Through the CPTPP, Canada will soon have preferential access to half a billion consumers in the world's most dynamic and fast-growing market," Champagne said in a statement late Tuesday.

"We wanted a good deal, and that's what we got for Canadian workers and their families."

The analysis also said the gains would cover a broad range of sectors, including some agricultural products such as pork and beef, wood products, machinery and equipment, and transportation equipment.

The federal government says the trade pact covers 495-million people with a combined gross domestic product of $13.5 trillion, or 13.5% of global GDP.

The 11 nations in the CPTPP are Canada, Australia, Brunei, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore and Vietnam.

7. B.C. budget hikes foreign buyer tax to 20%

[February 20, 2018] British Columbia moved to ease the province's housing crisis Tuesday with a new tax on property speculators and higher taxes on foreign homebuyers with a budget that plans to create 114,000 affordable housing units over the next decade.

Finance Minister Carole James said the tax measures are part of the government's aim to improve housing affordability in markets where some seniors are forced to live in their vehicles and young professionals are refusing to take jobs in B.C. because they can't find a place to live.

"We can't fix the housing crisis overnight but we can act," said James. "A budget is more than revenue and expenses. A budget is about people. It's about the kind of communities we want and the kind of future we want."

The minister defended the new and increased taxes in her budget as the right path to restore affordability.

Easing the financial pinch felt by families was a recurring theme in the first full budget brought in by the NDP since it came to power last summer.

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Easing the financial pinch felt by families was a recurring theme in the first full budget brought in by the NDP since it came to power last summer.
"We live in province rich in people, resources, natural beauty and opportunities," James said in her budget speech. "Yet those opportunities have become further and further out of reach for many."
B.C.'s housing crisis was a major issue in last year's provincial election that saw the New Democrats form a minority government with the backing of the three-member Green caucus, ending the Liberals' grip on power after 16 years in what was largely seen as a rebuke of its tight-fisted fiscal management that neglected spending on social programs.
James said the budget reflects the outcome of the election.
"It's time for a different approach," she said. "It's time everyone in our province is part of our prosperity."
The speculation tax will come in later this year, targeting foreign and domestic buyers who do not pay B.C. income tax in Metro Vancouver, the Fraser Valley, the Victoria-area, Nanaimo Regional District, Kelowna and West Kelowna.
The foreign buyers tax jumps from 15% to 20% on Wednesday and will be expanded beyond Metro Vancouver to include much of southern Vancouver Island, the central Okanagan and the Fraser Valley.
"Our goal is fairness," said James. "This is a major step to end speculation in our marketplace. We're asking those who benefited from high prices to give a little bit back."
The government will also eliminate medical services premiums on Jan. 1, 2020, saving individuals up to $900 annually and families $1,800. It will be replaced with a new payroll tax on employers, although those with payrolls under $500,000 will be exempt.
James described the government's plan to invest more than $1 billion in child care as historic for B.C. The money will help create more than 22,000 spaces and offer monthly benefits of $1,250 to 86,000 families.
James said despite a shortfall of more than $1 billion at the Insurance Corporation of British Columbia and the high cost of fighting last year's wildfires, the budget is forecast to have a surplus of $219 million for 2018-19.
Economic growth is forecast at 2.3% this year and the jobless rate of 5.1% last year was the lowest in Canada.
"The budget is balanced in its approach and it's fiscally balanced," James said. "It makes a historic investment to take care of children. It takes bold steps to tackle the housing crisis."

8. Shrinking middle class presents challenge for federal budget

[February 20, 2018] Computer programmer David Galvin should be the quintessential beneficiary of next week's federal budget, which is expected to continue the Liberals' persistent rhetoric and focus on bolstering the middle class.

He is educated, has had a career in advanced technology and lives in the economic heartland of southern Ontario.

But Galvin no longer includes himself in the middle class.

Like a growing number of Canadians, the 65-year-old from Hamilton says he has fallen behind—and that's a challenge, experts say, to Prime Minister Justin Trudeau's approach to fiscal policy.

A recent poll conducted by Ekos Research for The Canadian Press suggests fewer than half of all Canadians now identify as members of the middle class—a steep drop from nearly 70% in 2002.

In Galvin's hometown of Hamilton, 22% say they've fallen behind in their social class in the last five years. That was the highest concentration in the country, tied with Halifax and Kitchener.

Another 55% of Hamilton respondents say their situations haven't improved over the last five years.

Ekos president Frank Graves adds the numbers point to a large shift in what it means to be a member of the middle class in Canada.

"The whole notion of a middle-class dream—'I work hard, build a better mousetrap, do better than my parents, my kids do better than me, I get a house, a car, retire in comfort'—that has all been shattered," says Graves.

Graves points to higher income inequality and slower economic growth as reasons for the shrinking middle class. "A lot of people are stagnating or falling behind and they're not happy."

While the Liberals have covered their bases by expanding their appeals to the middle class to include "those working hard to join it," Canadians like Galvin have no such aspirations.

He has two bachelor's degrees from the University of Guelph and spent most of his career working in his field. However, after he lost his job more than a decade and a half ago, he has struggled to make ends meet.

"I was unable to get meaningful middle-class work again and ended up doing a lot of contract and short-term work," says Galvin.

The loss of his wife, Norma, in 2002 and a worsening gambling addiction only made things worse.

“I don’t really see myself as a middle-class person,” says Galvin. “I’ve had many years of precarious employment and it’s been a long time since I actually had a professional, middle-class type of job.”

Despite now having full-time work as a security guard and receiving CPP benefits and OAS, Galvin still worries about the future.

Many in his community and across the country share that uncertainty, according to Sara Mayo, a social planner at Hamilton’s Social Planning and Research Council.

“People feel like they are working harder and not getting ahead,” she says. “That is seen across Canada and certainly in Hamilton as well.”

One possible solution to the growing problem, says Mayo, is for the federal government to speed up its funding for the National Housing Strategy, a 10-year, $40-billion initiative to provide more affordable housing to lower-income families.

Most of that $40 billion, split between federal and provincial investments, won’t start rolling into communities until after 2020. Mayo says communities need more of that funding now to address a growing housing crisis and the mayors of Canada’s biggest cities agree.

Last Thursday, the Federation of Canadian Municipalities big-city mayors caucus met Finance Minister Bill Morneau to ask him to speed up the flow of cash.

Edmonton Mayor Don Iveson says the money is needed faster so that cities can focus on repairing hundreds of thousands of affordable housing units as soon as possible.

“There are units that are not … habitable right now because they’ve been waiting so long for that investment and we’d like to get those back in the hands of Canadians who need them and create the jobs now, not in a year or two,” Iveson told a news conference Thursday.

Housing isn’t an issue for Galvin but, as far as he’s concerned, more help for low-income Canadians can’t come soon enough.

“All you have to do is walk around downtown Hamilton to see what the effects of poverty and low-income work are.”

About the survey: The telephone poll of 7,882 Canadians was conducted Nov. 7 to Dec. 10, 2017 and had a margin of error of plus or minus 1.1 percentage points, 19 times out of 20.

Have a nice and fruitful week!