Weekly Updates Issue # 657

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1. Weekly Markets Changes

[March 29, 2018]

S&P TSX	S&P 500	Dow Jones	NASDAQ	CAD/USD	Gold	WTI Crude
15,367.29 +143.6 +0.94%	2,640.87 +52.61 +2.03%	24,103.11 +569.9 +2.42%	7,063.45 +70.78 +1.01%	$0.7756 -0.22c -0.28%	$1,325.47 -21.86 -1.62%	$64.94 -0.94 -1.43%

2. Economy dipped 0.1% in January: Statistics Canada

[March 29, 2018] The Canadian economy contracted 0.1% in January, hurt by unscheduled maintenance shutdowns in the oilpatch and weakness in the real estate sector following mortgage rule changes, Statistics Canada said Thursday.

The agency said the drop in real gross domestic product for January compared with growth of 0.2% in December.

Economists had expected an increase of 0.1% for the first month of the year, according to Thomson Reuters.

"This year started off with more of a whimper than a bang, at least from a growth perspective," TD Bank senior economist Brian DePratto wrote in a report.

"As usual though, the trend is more important than the noise. Clearly the pace of economic activity has moderated from last year's red-hot first half performance, but this is to be expected in an economy with little slack remaining."

Goods-producing industries fell 0.4% in January, while services-producing industries were essentially unchanged for the month.

Overall, the mining, quarrying, and oil and gas extraction sector posted its biggest drop since May 2016 as it fell 2.7% in January.

Non-conventional oil extraction fell 7.1% due to unscheduled maintenance shutdowns, while conventional oil and gas extraction fell 0.5% on lower crude petroleum and natural gas extraction.

Derek Holt, vice-president and head of capital market economics at Scotiabank, said in a report Thursday that the economy saw basically no growth even excluding the hit to one sector.

"Q1 growth tracking indicates a stalled economy," wrote Holt in the report. "The overall tone of the report should feed a cautious Bank of Canada policy bias."

Mining excluding oil and gas extraction fell 0.8% in January.

Meanwhile, real estate and rental and leasing fell 0.5% after six consecutive months of growth.

The output of offices of real estate agents and brokers posted its largest monthly decline since November 2008 as it fell 12.8% in January in the wake of the implementation of new mortgage rules, including stress-testing for uninsured mortgages.

Statistics Canada said lower activity in real estate contributed to a 0.1% drop in the professional, scientific and technical services sector as legal, accounting and related services contracted 1.9%.

3. Ontario budget highlights

[March 29, 2018]

Regulatory measures

- **Financial planners** – The 2018 budget states that the government is developing a framework to regulate financial planners in Ontario, the purpose of which would be "to close the gap that currently allows financial planners to perform their work without regulatory oversight or specified proficiency requirements. "Specifically, the government states that this regulatory framework would establish restrictions on the use of titles. To that end, a consultation was recently launched on proposals to restrict the use of the title "Financial Planner" to individuals holding a recognized financial planning credential, as well as proposals to prohibit the use of titles similar to "Financial Planner. "The government is accepting comments from the public and stakeholders on its proposals until April 16, 2018. For details, visit the Ontario Ministry of Finance's Consultation Paper.
- **Embedded commissions and best-interest duty** – There is no mention of the consultation by the Canadian Securities Administrators and the Ontario Securities Commission (OSC) on the option of

discontinuing embedded commissions. There is also no mention of the Best Interest Standard or proposed targeted reforms. In its 2017 budget, the government committed to consulting with regulatory partners and stakeholders.

- **Strengthening OSC's enforcement** – The government plans to propose new tools for the OSC to enhance and expand its existing enforcement activities. It also proposes to strengthen the framework for securing compensation for investors who suffer financial losses due to the acts or omissions of registered firms.

Tax measures

- **Simplifying Ontario's personal income tax** – The 2018 budget proposes to simplify Ontario's personal income tax system by eliminating the surtax and replacing it with new rates and brackets effective for the 2018 tax year. The government indicated that "over 83% of Ontario's 11 million tax filers would not see any increase in their PIT as a result of the proposed changes, and many would pay less.
- **Paralleling federal measures for private corporations** – The Ontario government will parallel measures introduced by the federal government related to income sprinkling and passive investment income. It will, similarly, close tax loopholes related to the use of sophisticated financial instruments and structured share repurchase transactions by certain Canadian financial institutions to realize artificial tax losses.

Pharma, health and child care

- **Support for seniors** – Starting in August 2019, OHIP+ will be expanded to seniors, eliminating the annual deductible and co-payment for seniors under the Ontario Drug Benefit (ODB) program. Seniors' prescription medications funded through the ODB program will be free of charge regardless of income. There will also be a new Seniors' Healthy Home Program, starting in 2019, which will provide a benefit of up to $750 annually for eligible households led by seniors 75 and over.
- **New Ontario drug and dental program** – Starting in summer 2019, a new program will reimburse up to 80% of eligible prescription drug and dental expenses for individuals and their families who do not have coverage from an extended health plan.
- **Child care for preschool-aged children** – Beginning in September 2020, Ontario will implement free licensed child care for preschool-aged children from the age of two-and-a-half until they are eligible for

kindergarten. The government indicates that an average Ontario family with a preschool-aged child could save over $17,000.

4. Ontario debt mounts as province moves back into deficit

[March 28, 2018] Ontario's debt is ballooning as the Liberal government takes the province back into deficit in its final budget before a spring election. After bringing the books to balance last year for the first time in a decade, the province's fiscal plan delivered Wednesday projects a deficit of $6.7 billion in 2018-2019, followed by deficits of $6.6 billion and $6.5 billion in each of the subsequent years.

Ontario's net debt, meanwhile, is projected to be $325 billion this year—or more than $22,500 per Ontarian—up from $308.2 billion expected as of March 31, 2018. The debt level is projected to grow to $360.1 billion by 2020-2021.

The Liberals' decision to run a deficit reverses a key promise to stay in the black this year. The government had also previously projected the balance would extend to 2020. The province now anticipates its annual deficit will decrease gradually until 2024-2025.

The overall size of the budget, which pumps billions into healthcare, childcare and other programs, has grown to $158.5 billion this year, up nearly 12% from $141.1 billion last year.

Interest on debt remains the government's fourth-largest spending area at $12.5 billion this year, and is projected to grow to $13.8 billion by 2020-21, and $16.9 billion by 2025-26.

Finance Minister Charles Sousa defended the province's deficit and mounting debt, saying Ontario's strong economy is what enables the government to afford increased spending.

He also said the government has built in a "tremendous amount of prudence and reserves" in its fiscal plan for any potential shocks to the system.

"I'm confident that as we move forward to invest in our economy, it will create greater growth, enabling us to have a stronger GDP and we'll come to balance," Sousa said.

But Progressive Conservative Leader Doug Ford lambasted the Liberal government's planned deficits, saying taxpayers would end up "stuck with the bill."

"Relief is on its way," Ford said. "We will restore fiscal responsibility in Ontario."

Ford stopped short, however, of saying a Tory government would balance the budget in its first year if it was to win power. He said his party needs to take a closer look at the provincial books, given that Ontario's auditor general has previously criticized accounting practices used by the Liberal government.

Economists say there is little rationale for the provincial government to go back into deficit given the strength of the Ontario economy.

The unemployment rate was 5.5% in February, one of the lowest jobless rates the province has seen. Meanwhile, Ontario's economy has been strong, with estimated real GDP growth of 2.7% in 2017. Real GDP growth is expected to slow to 2.2% in 2018, and fall to 1.7% by 2021.

Conference Board of Canada economist Craig Alexander said while there is some logic for programs in the budget such as free child care for preschoolers that will increase labour participation in the long run, the growing cost of servicing a larger debt cuts into spending on other priorities.

"When the unemployment rate is close to […] full employment, there's not much slack in the labour market, and the economy is delivering solid growth, there really isn't a rationale for running deficits. At least not an economic rationale," Alexander said.

Going into deficit now and in the coming years restrains the government's ability to take a hit when the economic cycle takes a turn, said Douglas Porter, chief economist with BMO Financial Group.

"Eventually we will hit heavier weather. And ideally you would like to see government finances in relatively strong shape when we hit that heavy weather," he said.

The net-debt-to-GDP ratio is up to roughly 37.6% this year, marking the first increase since it peaked in 2014-15 at 39.3%.

Going forward, the provincial government forecasts that the net-debt-to-GDP ratio will stay below the 2014-15 peak, but not resume a downward trend until 2022-23.

In last year's budget, the provincial government said it hoped to lower the net-debt-to-GDP ratio to pre-recession levels of 27% by 2029-30, and set a target of reducing that number to 35% by 2023-24. Those targets no longer appear in the latest budget, and the province is projecting a net-debt-to-GDP ratio of 35.5% by 2025-26.

5. Ontario restructures personal taxes

[March 28, 2018] The Ontario budget has introduced a plan to restructure the province's tax brackets and eliminate a surtax paid by filers.

The government says that in 2018, 8.6 million individuals wouldn't be affected by the changes, but 1.8 million people would pay about $200 more on average. About 680,000 people would see a tax reduction of about $130 on average.

The budget says that under the proposed changes, a person earning $95,000 would no longer pay surtax, but would also pay $168 more in personal income tax in 2018.

Ontario will also enhance support for charitable giving by increasing the top rate of the non-refundable Ontario Charitable Donations Tax Credit. Currently, a rate of 5.05% applies to the first $200 of donations, while there's a rate of 11.16% for donations that exceed that limit.

Going forward, Ontario will not increase the rate for donations of $200 or less. It will, however, hike the OCDTC rate to 17.5% for all taxpayers for eligible donations exceeding $200.

The budget also enhances current corporate tax credits, including the Ontario Innovation Tax Credit and the Ontario Research and Development Tax Credit.

Ontario parallels income sprinkling measures

Following the federal government's crackdown on income sprinkling, the Ontario government has proposed in its 2018 budget to "parallel those changes" once the feds' amendments are approved.

The provincial government plans to apply "its top [personal income tax] rate of 20.53% to split income received by an adult family member."

The budget also proposes to follow "the federal measure on passive investment income," which the federal budget provided more clarity on.

Currently, the budget says, "Ontario's small business deduction reduces the Ontario general [corporate income tax] rate for small CCPCs and associated corporations, on up to $500,000 of qualifying active business income." That limit, it adds, "is phased out on a straight-line basis for CCPCs (and associated corporations) that have between $10 million and $15 million of taxable capital employed in Canada."

The federal government's 2018 budget proposed "an additional phase out" of the small business limit, effective after the 2018 tax year, for corporations that earn between $50,000 and $150,000 of passive investment income in a year. Ontario proposes to parallel the federal measure.

6. Ontario's latest moves on syndicated mortgages

[March 28, 2018] In its 2018 budget, the Ontario government outlined the steps it has taken to protect investors against the risks of syndicated mortgage investments (SMIs).

These investments, which are private debt agreements for real estate projects that often promise attractive annual returns, will now be subject to a $60,000 investment limit on individual investors. The government amended regulations under the Mortgage Brokerages, Lenders and Administrators Act, 2006, as planned in last year's budget.

The 2018 budget says those amendments will also "ensure that potential investors are aware of the risks regarding SMIs." The government says it's aiming to "prevent investors from becoming overly concentrated in these investments," and that its regulatory amendments will come into effect as of July 1, 2018.

As reported by Advisor.ca in May 2017, some SMIs can come with risky backing or excessive commissions. As a result, investors need to assess a project's prospects and quality of underwriting.

The Ontario budget also mentions that the OSC will take over regulatory oversight of SIMs, in place of the Financial Services Commission of Ontario. The government's measures are meant to provide "interim" support as that transfer is made.

On March 8, CSA released proposed amendments related to syndicated mortgages for a 90-day comment period ending June 6. To streamline how SIMs are regulated across Canada, and consistent with the government's changes, the national regulator wants to "remove the mortgage exemptions for syndicated mortgages in Newfoundland and Labrador, the Northwest Territories, Nova Scotia, Nunavut, Ontario, Prince Edward Island and Yukon."

The exemptions don't exist in Alberta, British Columbia, Manitoba, New Brunswick, Quebec and Saskatchewan.

Among other changes, CSA would also require alternative prospectus exemptions for the distribution of SIMs. As a result, CSA said in its March 8 release, "[…] We expect that syndicated mortgages will most likely be offered primarily under the accredited investor exemption under section 2.3 of NI 45-106 (the AI exemption), the OM exemption, or the family, friends and business associates exemption under section 2.5 of NI 45-106." The OM exemption, it adds, allows for the sale of securities to retail investors if there's "adequate disclosure" to purchasers.

CSA's goal is to help investors make "more informed investment decisions" as well as "enable registrants involved in the distribution to better fulfill their obligations."

7. Is regulatory uncertainty the new norm for Ontario?

[March 28, 2018] The 2018 Ontario budget offers enough information on financial industry reform to pique interest, but not enough to shed light on future regulatory processes.

The budget includes a note on the Liberal government's plan to develop a framework for financial planners, but it offers scant detail on how that will occur. The government says it's still committed to restricting titles and to closing "the gap that currently allows financial planners to perform their work without regulatory oversight or specified proficiency requirements," but the budget doesn't provide an implementation plan.

The Finance Department released a consultation document on the regulation of titles and advice earlier this month, for which the comment period ends Apr. 16.

The most prescriptive item in the budget, for the advice industry, is the government's update on its creation of the Financial Services Regulatory Authority of Ontario, or FSRA. This new body, which is set to replace the Financial Services Commission of Ontario (FSCO), will be a more "adaptive" regulator for consumers, investors and pension plan beneficiaries, the budget says.

It will be "fully operational by April 2019."

"The government is continuing to work with FSRA on a plan for the transition from the [FSCO]," the budget says, and the FSRA is in the process of establishing its organization structure and "upgrading key information systems." To help, the government will propose amendments to the Financial Services Regulatory Authority of Ontario Act, 2016.

At the same time, the budget says the government continues to work on establishing the Cooperative Capital Markets Regulatory System (CCMR), which was brought to the table by the previous federal Conservative government. The budget reiterates Canada is the only G7 country without a national securities regulator, which is why it wants a CCMR to help provide "increased protection" for investors and strengthen Canada's international regulatory presence. Currently, only five provinces and the Yukon have committed to the regulator.

Separately, the budget talks about updating Capital Markets laws. That will include "new tools" for the OSC "to enhance and expand" its enforcement powers. That will include streamlining of the administrative penalty process for first-time violations.

What's not clear is whether these initiatives are linked to the budget's mention of tougher financial planner oversight.

The government's March 2018 consultation on titles reform is also vague. The document, which aims to gather feedback, offers a list of possible titles, which “should not be considered exhaustive,” it says, and adds the government will “consider an appropriate transition period” if affected advisors need to upgrade their credentials.

Prema Thiele, partner at Borden Ladner Gervais in Toronto, says it’s important for the government to recognize that how advisors use titles isn’t necessarily “a matter of title inflation.” Titles are often used to help explain “the breadth of their services,” so that functionality is important.

The government has previously referenced what it refers to as a gap in financial industry oversight when it comes to titles. But this ignores the fact that current regulators have proficiency standards, says Thiele. The government is also focused on a large selection of individuals, from wealth planners to those specializing in mortgage and insurance, she adds, so “I’m not sure their plans will materialize as they hope. If you move to a large, integrated financial system,” it’s unclear how one regulator will be able to look at everyone.

Also, says Thiele, “What will happen to individuals in the security industry who are already engaged in defined areas of the industry? Will these reforms be outside or part of current rules?” While the government’s current consultation mentions a transition plan, there’s also CSA’s reforms to consider—the latest CSA update, from May 2017, focused most on its targeted reforms that also deal with titles, and said proposed rules would come in 2018.

The March 2018 consultation also asks questions about the OSC and FSCO, but there’s no further detail on their role.

This contrasts with the final report on regulatory policy alternatives that was delivered to Ontario’s Ministry of Finance in March 2017, and dated Nov. 1, 2016. That report, written by an external expert committee appointed in 2015, recognized the current regulatory framework, including the work of CSA, OSC, IIROC and MFDA. It also recommended that titles reform, along with the implementation of a statutory best interest duty, be driven by an empowered FSRA and OSC.

In his budget speech, and when speaking with reporters, Finance Minister Charles Sousa didn’t provide further details. Notably absent from both the budget and his comments was any mention of the best interest standard or a national registry for planners.

8. Aging population has reduced monetary policy’s effectiveness: C.D. Howe

[March 27, 2018] Canada's aging population has reduced the effectiveness of monetary policy, says a new report by the C.D. Howe Institute.

The report, Faulty Transmissions: How Demographics Affect Monetary Policy in Canada, used inflation and unemployment rates to study the impact of demographics on the effectiveness of Canada's monetary policy from 1992 to 2015.

The report's authors, Steve Ambler and Jeremy Kronick, found that in this time period, Canada's inflation rate was an average 1.5%—below the Bank of Canada's target of 2% despite low interest rates and stimulative monetary policy.

"Canada's aging population is likely a leading cause of the systematic undershooting of inflation we have seen since the financial crisis," said Ambler in a press release. "Specifically, an aging population that takes on less debt is less sensitive to changes in the interest rate."

The study explains that younger adults accumulate more household debt and pay off the debt as they age. Adults then become creditors later in life. Younger adults are therefore more sensitive to changes in interest rates.

Ambler and Kronick found lower interest rates increase household spending and therefore inflation. The increases are smaller, though, when households are carrying less debt. The study found that Canada's aging population reduced the effectiveness of monetary policy through its impact on spending.

"Credit plays an important role on the real economy—it magnifies the reduction in the effectiveness of monetary policy that comes from an aging population," said Kronick in the press release. "Because of population aging, lower interest rates have not generated the typical increase in spending, leading to subdued inflation and lower economic growth."

The study's results found that Canada's policy framework for targeting inflation is good, but not perfect. Changes to the Bank of Canada's overnight lending rate will be needed to meet the Bank of Canada's inflation target. Unconventional monetary policy may also be necessary if expansionary monetary policy is more difficult to achieve because of a lower neutral rate of interest.

Have a nice and fruitful week!