Weekly Updates Issue # 678

1. Weekly Markets Changes

[August 24, 2018]

S&P TSX	S&P 500	Dow Jones	NASDAQ	CAD/USD	Gold	WTI Crude
16,356.05 +32.34 +0.20%	2,874.69 +24.56 +0.86%	25,790.35 +121.0 +0.47%	7,945.98 +129.7 +1.66%	$0.7671 +0.45c +0.59%	$1,205.36 +21.11 +1.78%	$68.72 +2.81 +4.26%

2. Fed's Powell hints at road ahead for rate hikes

[August 24, 2018] Federal Reserve Chairman Jerome Powell signalled Friday that he expects the Fed to continue gradually raising interest rates if the U.S. economic expansion remains strong.

The Fed leader forecast that while annual inflation has risen to near the Fed's 2% target rate, it doesn't seem likely to accelerate above that point. That suggests he doesn't foresee a need for the Fed to step up its rate hikes. Late next month, the Fed is widely expected to resume raising rates.

Speaking to an annual conference of central bankers in Jackson Hole, Wyoming, Powell said the Fed recognizes that it needs to strike a careful balance between its mandates of maximizing employment and keeping price increases stable. He said a gradual approach is the best way for the Fed to navigate between the risks of raising rates too fast and "needlessly shortening the expansion" and moving too slowly and risking an overheated economy.

Powell began his speech by pointing to the growing strength of the U.S. economy, with the unemployment rate declining steadily for almost nine years and reaching a near 20-year low at 3.9%.

"There is good reason to expect that this strong performance will continue," he said.

But the U.S. also faces challenges, which “are mostly beyond the reach of monetary policy,” he said. Those include slow growth in real wages for medium- and low-income workers and the country’s “unsustainable” federal budget deficit, Powell said.

Powell made no mention of the recent public criticism from President Donald Trump, who has said he’s unhappy with the Fed’s rate hikes. The president has complained that the Fed’s tightening of credit could threaten the continued strong growth he aims to achieve through the tax cuts enacted late last year, a pullback of regulations and a rewriting of trade deals to better serve the U.S.

Many have seen Trump’s complaints about the Fed’s rate hikes as an intrusion on the central bank’s longstanding independence from political influence. Two top Fed officials made clear Thursday that Trump’s criticism won’t affect their decisions on whether to continue raising rates.

Powell also made no mention in his speech of what many economists see as the most serious threat to the economy: the trade war that Trump has launched with America’s main trading partners—a conflict that risks depressing U.S. and global economic growth the longer it goes on.

The Fed chairman focused his remarks, in part, on the difficulty the Fed faces in setting interest-rate policies at a time when the economy seems to be undergoing changes that challenge long-standing beliefs of how low unemployment can fall before it ignites inflation pressures. He said there is also much uncertainty over the “neutral” rate of inflation—the point at which the Fed’s policy rate is neither stimulating economic growth or holding it back.

The Fed’s economic projections, compiled from estimates of all Fed officials, estimates the current neutral rate at 2.9%. But Powell noted that there’s a wide difference of opinion about it.

After having kept its key policy rate near zero for seven years to help lift the economy out of the Great Recession, the Fed has raised rates seven times, most recently in March and June this year. Most Fed watchers foresee two more hikes this year, next month and then in December.

The Fed is on a “one-hike-per-quarter path this year” but may take it slower in 2019, said Avery Shenfeld, managing director, economics, at CIBC World Markets, in Friday commentary. This could occur “as rates get closer to where the Fed might see the neutral rate lying,” he wrote.

In the meantime, Powell’s comments show the central bank will remain dependent on data as it hikes, said Derek Holt, vice-president and head of Capital Markets Economics at Scotiabank, in his commentary. The Fed believes this “is the right course of action,” he wrote, adding, “A big part of the reason is that he/they have low confidence in estimates of the long run policy guideposts."

Overall, Holt said Powell's speech highlighted "the steady hand" and "stewardship" he's providing in the face of uncertainty.

3. What's really going on with China's economy?

[August 24, 2018] China's economy is slowing down. But how much trouble is it in?

The recent weakness comes as the country is fighting a trade war with the United States. The world's top two economies have now imposed tariffs on $50 billion of each other's goods, and are threatening far more.

President Donald Trump's top economic adviser, Larry Kudlow, said this month that the Chinese economy "looks terrible" while the US economy is "crushing it."

The reality is more nuanced, but what happens in China's economy affects businesses around the globe. Its huge manufacturing industries suck in parts and materials from countries around the world, fashioning them into goods for export or for sale in China.

Growth slowdown

China is one of the world's fastest growing major economies — it expanded 6.9% in 2017, according to government figures. But it has started to lose steam this year, and signs of further weakness are multiplying.

Official data for July showed a slowdown in investment, factory production and retail sales.

The trade war with the United States is also a worry, but not the biggest.

"The US-China trade conflict will be a drag on activity, though probably a small one. Instead, we expect the economy to weaken mainly due to domestic headwinds caused by slower credit growth," Chang Liu, China economist at research firm Capital Economics, wrote in a note to clients this week.

But some experts think that slowdown fears have been overblown. Douglas Morton, head of Asia research at brokerage Northern Trust Capital Markets, pointed out that some indicators like demand for oil and the property market are still strong.

"Headlines on growth concerns may prove to be somewhat exaggerated," he wrote in a note to clients this week.

Market slump

China's stock market and its currency have been pummeled by investors concerned about the health of the country's economy and the impact of the trade war.

Its main stock index, the Shanghai Composite, slipped into a bear market two months ago and is now down about 23% from its recent peak in January.

The country's currency, the yuan, has shed about 9% versus the US dollar since April. That decline is partly down to the US Federal Reserve raising interest rates, which makes it more attractive for investors to hold assets in US dollars and sell those in other currencies.

Even though a weaker yuan makes Chinese exports cheaper, helping offset the impact of US tariffs, analysts suggest that Beijing is more concerned with propping up the currency to avoid a steep plunge that could spook investors.

"If anything, the authorities have tried to slow the pace of depreciation," said Aidan Yao, senior emerging markets economist at AXA Investment Managers.

Debt burden

China's slowdown comes as Beijing is trying to tackle the country's heavy debt burden, a legacy of its huge stimulus programs in the wake of the global financial crisis.

The biggest worries surround the alarmingly high levels of debt held by companies, especially China's bloated state-owned enterprises.

President Xi Jinping and other top officials have called for China's financial system to cut down on riskier lending, a campaign often referred to as "deleveraging." Authorities have tried to crack down on China's vast shadow banking sector in which murky forms of lending are kept off banks' official balance sheets.

But analysts worry that a slowdown in lending will weigh on the economy.

"The biggest growth headwind is from the deleveraging campaign," Larry Hu, an economist at investment bank Macquarie, wrote in a recent note to clients.

Economic stimulus

China has been looking for ways to pump up the economy as growth slips.

Beijing has announced a range of measures including tax cuts, infrastructure spending and new loans to business. The government said the moves are intended to help China cope with "an uncertain external environment."

The People's Bank of China has injected huge sums into the financial system by providing new loans and reducing the amount of deposits commercial lenders are required to hold.

"Even if Chinese economic growth were to slow, Beijing still has many policy levers to cushion a downturn," Cam Hui, a strategist at research firm Pennock Idea Hub, said in a research note.

But the Chinese government insists it has no plans to go on a spending binge the way it did in the aftermath of the financial crisis.

"We aren't talking about massive stimulus, nor do we want to incur financial risks, let alone getting the government to take care of everything," Finance Minister Liu Kun said in an interview Thursday with Reuters.

4. Longevity gap between rich and poor impacts pensions, annuities: study

[August 24, 2018] Differences in the life expectancies of rich and poor Canadians could affect pension policy and annuities, a study from the C.D. Howe Institute says.

High earners living longer change the balance of pension contributions and benefits, says the study, called "Rich Man, Poor Man: The Policy Implications of Canadians Living Longer."

"If those who are living longest are the ones with the highest annual pension benefits, then the total costs of the pension payouts may be higher than expected," it says.

The study's findings, based on data from CPP contributors born between 1923 and 1955, is relevant to private annuity markets, which are shaped by the longevity expectations of potential purchasers. The authors also said the relationship between income and longevity could impact public retirement income programs.

The study says the highest-earning Canadian women are living longer than the lowest-earning women by three years. For men, the difference is eight years.

Since 1965 the life expectancy of women has increased by 6.4 years after the age of 50, and by 7.7 years for men. The study used a sample of people alive at age 50 that's representative of the working population outside Quebec and who had contributed to CPP at least once.

The study didn't find a causal relationship between earnings and longevity, as life expectancies have improved across all earnings levels. Higher education and different health habits may affect longevity more than income, it said, and the longevity gap has not grown over time.

"However, longevity is a highly valued aspect of well-being, so its distribution across different types of Canadians matters," co-author Kevin Milligan said in a release.

5. Why clients could soon access a lot more real estate data

[August 23, 2018] The Supreme Court of Canada has refused to hear an appeal from the country's largest real estate board that would have prevented its members from posting home sales data on their websites, ending a years-long battle in a case that could have sweeping implications for consumer access across the country.

Canada’s top court announced Thursday it has dismissed the application from the Toronto Real Estate Board, which represents more than 50,000 Ontario agents.

TREB’s appeal stemmed from a seven-year court battle that began in 2011 when the Competition Bureau challenged its policy preventing the publication of such information, arguing it impedes competition and digital innovation.

The board had argued at the Competition Tribunal and later the Federal Court of Appeal that posting such data on password-protected websites would violate consumer privacy and copyright.

Both judicial bodies sided with the bureau, prompting TREB to take the fight to the Supreme Court of Canada.

Lawyers and realtors have said that if the data is made available online, buyers and sellers will be able to more easily educate themselves on how to price homes and negotiate and won’t have to rely on agents for getting information.

Since the court won’t hear the case, lawyers believe there is likely nothing TREB can to do to keep its legal battle going and the data from being posted.

TREB chief executive officer John DiMichele said in a statement that the tribunal’s order will come into effect in 60 days time, unless it is modified.

DiMichele said the board will be studying “the required next steps to ensure such information will be protected in compliance with the tribunal order.”

Meanwhile, the Competition Bureau’s interim commissioner Matthew Boswell said in a statement that the ruling is “a decisive victory for competition, innovation and for consumers.”

“By removing TREB’s anti-competitive restrictions, home buyers and sellers in the GTA will now have greater access to information and innovative real estate services when making one of the most significant financial decisions of their lives.”

The Supreme Court decision is expected to result in a rush of agents starting to post sales data on their websites.

The data release will eventually spread to “pretty much every real estate market in Canada” because most were waiting to see how TREB’s case fared, said John Andrew, a real estate professor at Queen’s University.

The TREB case, he said, only covered realtors posting the information on their password-protected websites, but he expects the country will soon see a push to allow the numbers to be published without password protection because the numbers are already in the public domain.

The public can get such numbers currently by turning to real estate agents and brokers, who have access to the Multiple Listing Service database, where sales data is compiled when deals close. Others rely on online property value services like Teranet or local land registry offices, which charge a fee for the public to access sales data.

Christopher Alexander, the executive vice-president and regional director of RE/MAX Integra's Ontario-Atlantic business, suspects the case will set a precedent for real estate boards across the country, triggering a flood of other provinces to look to release similar data.

However, he doesn't think the decision will be an industry killer based on his observations in the United States, where a similar case has enabled consumers to access enhanced information for years, but real estate agents are still in demand.

"They had information available to consumers for the last 13 years and it hasn't been a detriment to realtors," he said.

"Good, experienced realtors are a lot more valuable than having sold information."

6. Retail sales fall in June, but GDP remains on track

[August 22, 2018] Economic data released Wednesday shed little light on the Bank of Canada's next move and don't alter forecasts for second-quarter GDP, a CIBC economist said.

Retail sales edged down 0.2% in June to $50.7 billion, following a 2.2% increase in May, says StatsCan.

In a report, CIBC senior economist Royce Mendes says the drop was expected and won't settle the debate between a September or October hike from Canada's central bank.

"We're still leaning towards the latter, but will be particularly attuned to the upcoming GDP report," he said, referring to the second quarter GDP data to be released Aug. 30. Wednesday's figures don't alter forecasts for a 3% annualized gain in quarterly GDP, he said.

Sales were down in six of 11 subsectors, representing 52% of total retail trade. Lower sales at gasoline stations and motor vehicle and parts dealers led the decrease. Excluding those two subsectors, retail sales were up 0.3%, which Mendes called "modest."

The monthly data's greater-than-usual volatility can be attributed to adverse weather conditions that restrained spending in April, and reversed course in May, said Mendes. The outsized May gain likely resulted in "a bit of hangover" in June's spending numbers.

Mendes expects Q3 data to look more trend-like as there haven't been any major disruptions thus far in the quarter.
Wednesday's economic data didn't affect markets, he added.

7. Autos contribute to June wholesale sales drop

[August 21, 2018] Statistics Canada says wholesale sales fell 0.8% in June to $63.1 billion.
The drop came as the motor vehicle and parts subsectors saw sales drop 1.9% to $10.9 billion.
The miscellaneous subsector fell 2.2% to $8.2 billion on lower sales in the agricultural supplies industry.
Overall, Statistics Canada says sales were down in five of the seven subsectors tracked, accounting for 71% of total wholesale sales.
Wholesale sales in volume terms fell 1.1%.
Royce Mendes, senior economist at CIBC World Markets, called the June numbers a "wholesale write-off."
In a research note, Mendes wrote that the drop came against a consensus forecast for a 0.7% gain. May's numbers were also revised down to 0.9% to 1.2%, he said.
"Overall, while this won't materially change tracking forecasts for a roughly 3% annualized gain in Q2, it is a sign that momentum might be tailing off to end the quarter," Mendes wrote.

8. OFSI designates largest banks 'systemically important'

[August 21, 2018] Canada's Office of the Superintendent of Financial Institutions (OSFI) legally designated Canada's six largest banks as "systemically important" on Tuesday and set guidelines for absorbing losses.
The designation comes as part of Canada's bail-in regime after the 2008 financial crisis showed certain banks were "systemically important," a background document says. The reforms are meant to ensure taxpayers aren't on the hook for losses by requiring banks to hold additional capital.
A 2016 amendment to the Bank Act gave OSFI the authority to designate banks as domestic systemically important banks (D-SIBs) and to designate their total loss absorbing capacity (TLAC). OSFI ordered the six banks to set the minimum risk-based TLAC ratio at 21.5% of risk-weighted assets and the minimum TLAC leverage ratio at 6.75%, a release said.

The framework lets a bank be recapitalized and remain operating without requiring taxpayer money or threatening financial stability in the "unlikely event of a failure," the release said.
The banks designated as D-SIBs are the Bank of Montreal, Bank of Nova Scotia, Canadian Imperial Bank of Commerce, National Bank of Canada, Royal Bank of Canada and Toronto-Dominion Bank.

9. Group led by Air Canada to acquire Aeroplan program

[August 21, 2018] A consortium led by Air Canada has reached a deal to acquire the Aeroplan loyalty program from Aimia Inc.
The group, which includes TD Bank, CIBC and Visa Canada Corp., has agreed to pay $450 million in cash and assume the approximately $1.9-billion liability associated with Aeroplan miles customers have accumulated.
"We are pleased to see that an agreement in principle has been reached as Aeroplan members can continue to earn and redeem with confidence," Air Canada chief executive Calin Rovinescu said in a statement on behalf of the consortium Tuesday.
"This transaction, if completed, should produce the best outcome for all stakeholders, including Aeroplan members, as it would allow for a smooth transition to Air Canada's new loyalty program launching in 2020, safeguarding their miles and providing convenience and value for millions of Canadians."
The price is up from an initial offer of $250 million in cash and the assumption of the reward point liability in July that was rejected by Aimia.
The deal is expected to close this fall.
The agreement, which is supported by Aimia's board and Mittleman Brothers, Aimia's largest shareholder, is subject to shareholder approval and other closing conditions.
Mittleman Brothers holds approximately a 17.6% stake in Aimia and agreed to vote in favour of the proposed transaction.
The future of the program has faced questions since Air Canada announced last year that it planned to launch its own loyalty rewards plan in 2020 when its partnership with Aimia expires.
Air Canada created Aeroplan as an in-house loyalty program, but it was spun off as an independent business as part of a court-supervised restructuring of the airline. At the time, CIBC was Aeroplan's main bank partner.

Since 2014, TD has been Aeroplan’s main Visa card partner although CIBC continues to offer cards that earn Aeroplan points that can be redeemed for Air Canada flights and other rewards.

Have a nice and fruitful week!

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