Weekly Updates Issue # 684

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1. Weekly Markets Changes

[October 5, 2018]

S&P TSX	S&P 500	Dow Jones	NASDAQ	CAD/USD	Gold	WTI Crude
15,946.17 -127.0 -0.79%	2,885.57 -28.4 -0.97%	26,447.05 -11.26 -0.04%	7,788.45 -257.90 -3.21%	$0.7730 +0.05c +0.06%	$1,203.63 +12.75 +1.07%	$74.34 +1.09 +1.49%

2. Canadian unemployment falls with rise in part-time jobs

[October 5, 2018] All of the job gains were in the 25-to-54 age range. Canada's job market gained 63,000 positions in September, edging the unemployment rate lower to 5.9%, and offsetting job losses in August, Statistics Canada reported Friday.

September's increase in employment was largely driven by gains in part-time work, with part-time jobs up by around 80,000, the agency said in its monthly labour force survey.

Economists had estimated the country would add 25,000 jobs in September, according to Thomson Reuters Eikon.

The job gains were also almost entirely in Ontario and British Columbia, with little change in the other provinces.

The latest monthly report from Statistics Canada indicates the jobs market remains volatile, after August saw a decline of more than 51,000 positions, raising the unemployment rate to 6.0%, after two months of increases

On a year-over-year basis, Canada gained 222,000 jobs since September 2017.

Statistics Canada also reported the Canadian international merchandise trade balance improved in August, recording a surplus for the first time since December 2016.

It said imports fell by 2.5% and exports declined 1.1%, producing a surplus of $526 million compared with July's $189 million trade deficit.
Taken together, the jobs and trade reports paint a rosier economic picture than anticipated, increasing the likelihood that the Bank of Canada will increase its trend-setting interest rate later this month, said BMO Financial Group chief economist Doug Porter.
"The big picture is that the economy overall is looking a bit better than anticipated, with the bias now squarely to the upside on growth," Porter headlined in a note to clients.
But the fact that the job gains were part-time, and the trade surplus was the result of declines in both imports and exports, takes some of the shine off the numbers, said Royce Mendes at CIBC Capital Markets.
Statistics Canada's monthly labour force survey found that all of the job gains in September were made by workers in the core 25-to-54 age range with virtually no change in youth employment. September's youth unemployment rate stood at 11.0%, up by 0.1 percentage points from the previous month.
Men in the core age bracket gained the most, with 34,000 jobs while women also saw increases of 20,000 positions.
The agency said the number of self-employed Canadians declined by 35,000 after recording an almost equal total increase over the past 12 months.
Many of the jobs were found in construction, up by 28,000 in September, reversing two previous monthly declines.
Around 13,000 jobs were added in finance, insurance, real estate and rental and leasing, mostly in Ontario and Alberta.
Employment increased by about 12,000 in the public sector, which has seen a rise of about 20,000 jobs overall since last September.
The agriculture sector also saw gains of about 9,000 jobs, offsetting continuous declines seen since May.
Statistics Canada also released third quarter employment numbers for the territories, reporting gains of 500 and 900 jobs in Nunavut and the Northwest Territories respectively while 400 job losses were recorded in Yukon. The numbers were compared with the second quarter and based on a three-month rolling average.

3. U.S. unemployment rate drops to lowest level in 49 years

[October 5, 2018] Companies are facing intense pressure to boost pay to find the workers they need. The U.S. unemployment rate fell to 3.7% in September—the lowest level since December 1969—while hiring slowed.

Employers added just 134,000 jobs, the fewest in a year, the Labor Department said Friday. But that figure was likely lowered by Hurricane Florence.

Florence struck North and South Carolina in the middle of September and closed thousands of businesses. A category that includes restaurants, hotels and casinos lost jobs for the first time since last September, when Hurricane Harvey exerted a similar effect.

Still, September extended the longest streak of hiring on record, with millions of Americans having gone back to work since the Great Recession. Healthy consumer and business spending has been fueling brisk economic growth and emboldening employers to continue hiring. The September gain extended an eight-and-a-half-year streak of monthly job growth.

Aside from the impact of the storm, the underlying trend in hiring remains strong. Job gains in August and July were revised sharply higher, to show 87,000 more jobs were added. Employers have added a robust 190,000 jobs over the past three months.

Last month, average hourly pay increased 2.8% from a year earlier, one tick below the year-over-year gain in August.

That figure could rise in the coming months. With the unemployment rate so low, companies are facing intense pressure to boost pay to find the workers they need. Amazon responded on Tuesday by raising its minimum wage to $15 an hour.

Consumers, business executives and most economists remain optimistic. Measures of consumer confidence are at or near their highest levels in 18 years. Retailers have begun scrambling to hire enough workers for what’s expected to be a robust holiday shopping season. A survey of service-sector firms, including banks, hotels and health care providers, found that they are expanding at their fastest pace in a decade.

Americans have continued spending steadily and appear to be in generally stable financial shape. Households are saving nearly 7% of their incomes — more than twice the savings rate before the recession. That trend suggests that a brighter economic outlook hasn’t caused consumers to recklessly build up unsustainable debt.

During the April-June quarter, the U.S. economy expanded at a 4.2% annual rate, the best in four years. Economists have forecast that growth reached a 3% to 3.5% annual rate in the July-September quarter.

The economy does show some weak spots. Sales of existing homes have fallen over the past year. Increasingly expensive houses, higher mortgage rates and a shortage of properties for sale are slowing purchases. Auto sales have also slumped.

Other threats loom, too. Borrowing costs for businesses and consumers are rising. Pointing to the economy's health, the Federal Reserve last week raised the short-term interest rate it controls and predicted that it would continue to tighten credit into 2020 to manage growth and inflation. Over time, higher borrowing costs make auto loans, mortgages and corporate debt more expensive and can eventually slow the economy.

But for now, anticipating stronger growth—and perhaps higher inflation—investors have dumped bonds and forced up their yields. The yield on the government's 10-year Treasury note, a benchmark for mortgages and other loans, has touched its highest level in seven years.

President Donald Trump's trade fights could also weigh on the economy, though the effect on hiring won't likely be felt until next year, economists say. The Trump administration has imposed tariffs on imported steel and aluminum as well as on roughly half of China's imports to the United States. Most U.S. businesses will try to absorb the higher costs themselves, at least for now, economists say, and avoid layoffs.

Still, should the tariffs remain fully in effect a year from now, roughly 300,000 jobs could be lost by then, according to estimates by Mark Zandi, chief economist at Moody's Analytics.

4. U.S. short-seller Muddy Waters takes aim at Manulife Financial Corp.

[October 4, 2018] Famed firm cites trial involving Manulife's insurance contracts. U.S.-based short-seller Muddy Waters has taken aim at Canadian insurer Manulife Financial Corp.

Carson Block, the firm's head of research, says in a report published Thursday that Manulife's life insurance subsidiary has just concluded a trial that could "significantly damage" the company and could lead to "billions of dollars of losses."

Muddy Waters says the trial involves one of Manulife's insurance contracts purchased by a hedge fund called Mosten Investment LP. The judge's decision is expected by the end of the year.

The research firm says Mosten argues that it can deposit an unlimited amount of money with Manulife through the contract and receive an annualized guaranteed return of at least 4%—terms that could "financially cripple" the Canadian insurer.

Shares of Manulife were down nearly 3% on the Toronto Stock Exchange at midday after Muddy Waters announced its short position in Manulife.

Manulife responded in a press release, saying it disagreed with the conclusions of Muddy Waters and believed Mosten's position is legally unfounded.

"We firmly believe that the consumers purchasing universal life policies, and the insurers issuing these policies, never intended to have the policies function as deposit or securities contracts," the release said. "We have a sound, highly rated global franchise."

Further, Manulife said it expects to prevail in the matter, which won't affect business operations or its ability to meet obligations to customers, vendors and other stakeholders.

5. Retirement saving trends and challenges

[October 3, 2018] Saving for retirement is important for more than 80% of working Canadians, though nearly as many (71%) aren't sure if they're saving enough and more than half (60%) haven't started building funds.

So says a Nest Wealth retirement report that examines how employees' financial stress can affect their personal lives, work performance and morale.

The report's release coincides with the digital wealth manager's release of Nest Wealth at Work, a group RRSP platform for small businesses.

"Stress is one of the contributing factors to poor health, and worrying about financial status is part of the problem," the report says.

Gender can also be at play when it comes to financial anxiety. The report notes 65% of men were wary of not saving enough versus 75% of women, due in part to the lower earning power of female employees.

To alleviate such anxiety, most respondents (82%) said they would invest through an employer's group RRSP, and almost 70% said they'd choose a job that came with a pension plan over one that didn't.

Using such a plan means people are more aware of their retirement options, with 79% of those who contribute knowing how much they need to save and only 47% worrying about meeting their goals.

However, "small businesses have been daunted by the effort to offer the sort of retirement plans that large enterprises do," the report says.

Additional retirement saving trends

In the third quarter, more than 60% of Canadian defined benefit pension plans were fully funded, and pensions had the highest solvency position in 18 years, according to Mercer's most recent Pension Health Index.

Factors positively affecting pensions plans included rising interest rates and strength in U.S. and international equity markets, despite market weakness domestically, a release from Mercer said. Those factors are leading some plan sponsors to consider more investment risk.

Separate data suggest that, aside from saving through work and pensions, Canadians are looking to sell their homes in their post-work years, with a 2017 OSC poll saying nearly half (45%) of homeowners aged 45 and older in Ontario are considering that option.

A more recent 2018 Schroders study found that, overall, working Canadians are saving less than their global peers (11.9% of their incomes, compared to the global average of 12.2%). That survey included responses from 22,000 investors in more than 30 countries.

The Schroders study found Canadians underestimated their post-work costs, with non-retirees expecting to spend 42% of their retirement incomes on basic living expenses compared to retirees actually spending more than half (59%).

6. More than 60% of Canadian DB pension plans fully funded: Mercer

[October 3, 2018] Rising interest rates and equity markets boosted funded positions. More than 60% of Canadian defined benefit pension plans were fully funded in Q3 as pensions had the highest solvency position in 18 years, according to Mercer's Pension Health Index.

The index represents the solvency ratio of a hypothetical pension plan. The ratio was 112% at the end of September, a rise from 107% at the end of June and 106% at the beginning of the year, a release from Mercer said.

Less than 5% of pension plans were below 80% funded on a solvency basis.

A rise in the long-term interest rates of 20 basis points in September boosted the funded position of pension plans, the release said. Other factors affecting pension plans included the strong performance of U.S and international equity markets.

A typical balanced pension portfolio would have dropped by 0.1% during Q3, the index said. Returns from U.S. and developed market equities rose, while Canadian equities were slightly negative. Canadian and emerging market fixed income were also down.

Rethinking risk strategies

Some plan sponsors are rethinking their risk strategies due to the improvement in funded positions and changes to funding rules in Ontario and Quebec, the release said.

"Some plan sponsors, particularly those that are not fully funded and that remain open to new members, feel emboldened by the new funding rules to maintain or even increase investment risk," the release said.

"On the other hand, this seems like a particularly opportune time for sponsors of closed and frozen defined benefit plans to take risk off the table, either by changing the asset mix or through risk transfers."

7. BoC studying issues around a central bank digital currency

[October 1, 2018] The Bank of Canada is looking at the key questions around the design of a digital currency and the issues surrounding such an idea, a senior Bank of Canada official said Monday.

However, deputy governor Timothy Lane told a University of Calgary audience that unless the risks associated with a central bank digital currency (CBDC) can be managed through appropriate design, the bank would not recommend issuing such a currency.

"The design of a CBDC has important implications for its risk and benefits," Lane said according to the prepared text of his speech released in Ottawa.

"Some major reasons for caution about a central bank digital currency are concerns that it could become a vehicle for illicit transactions or that it could have significant negative implications for financial intermediation."

Lane said the central bank uses the term cryptoassets to describe cryptocurrencies because they do not do a good job of performing the basic functions of money. The value of bitcoin has swung wildly, with it topping US$20,000 last year and now trading around US$6,000.

However, Lane said, as cryptocurrencies evolve they may touch on the central bank's core functions including monetary policy, financial stability, payments and currency.

He said the Bank of Canada is not responsible for regulating cryptocurrencies, but it has been examining the potential impact on the stability of the financial system.

Earlier this year, Bank of Canada senior deputy governor Carolyn Wilkins called on authorities to work toward a set of globally aligned policies governing cryptocurrencies. She said it was important to have a strategy on cryptoassets that was as consistent as possible across countries.

Lane said that differences in regulations around the world, together with the incompleteness of regulation in many jurisdictions leaves open room for regulatory arbitrage.

"Differences in the regulatory treatment of these products for controlling money laundering and terrorist financing are a particularly pressing concern," he said.

Lane noted that they do not yet pose financial stability risks, but things are evolving rapidly as cryptoassets grow in size, complexity and interconnectedness.

“As the underlying technologies and the design of crypto products evolve, we need to be ready to reassess how they might affect financial stability,” he said.

“Some potential aspects include the integrity of payment systems, bank business models and the exposures of financial institutions and infrastructures.”

8. Canada, U.S. reach deal to stay in trade pact with Mexico

[October 1, 2018] Deal will be called the United States-Mexico-Canada Agreement or USMCA. Canada was back in a revamped North American free trade deal with the United States and Mexico late Sunday after weeks of bitter, high-pressure negotiations that brushed up against a midnight deadline.

In a joint statement, U.S. Trade Representative Robert Lighthizer and Canadian Foreign Affairs Minister Chrystia Freeland said the agreement “will strengthen the middle class, and create good, well-paying jobs and new opportunities for the nearly half billion people who call North America home.”

The new deal, reached just before a midnight deadline imposed by the U.S., will be called the United States-Mexico-Canada Agreement, or USMCA. It replaces the 24-year-old North American Free Trade Agreement, which President Donald Trump had called a job-killing disaster.

Trump on Monday morning called it a “great deal,” tweeting that it “solves the many deficiencies and mistakes in NAFTA, greatly opens markets to our Farmers and Manufacturers, reduces Trade Barriers to the U.S. and will bring all three Great Nations together in competition with the rest of the world.”

He added: “Congratulations to Mexico and Canada!”

The agreement reached Sunday gives U.S. farmers greater access to the Canadian dairy market. But it keeps a NAFTA dispute-resolution process that the U.S. wanted to jettison and offers Canada protection if Trump goes ahead with plans to impose tariffs on cars, trucks and auto parts imported into the United States.

“It’s a good day for Canada,” Prime Minister Justin Trudeau said as he left his office. Trudeau said he would have more to say Monday.

“We celebrate a trilateral deal. The door closes on trade fragmentation in the region,” Jesus Seade, trade negotiator for Mexico’s incoming president, said via Twitter.

Representatives for the government of Mexican president-elect Andres Manuel Lopez Obrador have called a press conference to discuss details of the trade deal on Monday.

Canada, the United States' No. 2 trading partner, was left out when the U.S. and Mexico reached an agreement last month to revamp the North American Free Trade Agreement.

The Trump administration officially notified Congress of the U.S.-Mexico trade agreement on Aug. 31. That started a 90-day clock that would let outgoing Mexican President Enrique Pena Nieto sign the new pact before he leaves office Dec. 1.

Trump threatened to go ahead with a revamped NAFTA—with or without Canada. It was unclear, however, whether Trump had authority from Congress to pursue a revamped NAFTA with only Mexico.

Some lawmakers immediately expressed relief that Canada had been reinstated in the regional trading bloc. "I am pleased that the Trump administration was able to strike a deal to modernize NAFTA with both Mexico and Canada," said Senate Finance Chairman Orrin Hatch, R-Utah. "NAFTA is a proven success."

NAFTA tore down most trade barriers between the United States, Canada and Mexico, leading to a surge in trade between the three countries. But Trump and other critics said it encouraged manufacturers to move south of the border to take advantage of low-wage Mexican wages, costing American jobs.

Trump campaigned on a promise to rewrite NAFTA—or get rid of it. Talks on a rewrite began more than a year ago. To placate Trump, Mexico agreed in August to provisions that would require 40% to 45% of a car be built in countries where auto workers earn at least $16 an hour to qualify for NAFTA's duty-free benefits.

It was surprising that the United States found it easier to cut a deal with Mexico than with Canada, a longtime ally with a high-wage economy similar to America's. "When this got started, Canada was the teacher's pet and Mexico was the problem child," said Michael Camunez, president of Monarch Global Strategies and former U.S. Commerce Department official.

But relations between Ottawa and Washington soured. In the aftermath of a disastrous G-7 summit in Quebec in June, Trump called Trudeau "weak" and "dishonest."

The two countries need each other economically. Canada is by far the No. 1 destination for U.S. exports, and the U.S. market accounts for 75% of what Canada sells abroad.

9. Wins, losses and market effects of the new trade deal

[October 1, 2018] The loonie rallied Monday as the market responded to news of Canada joining a revamped North American trade deal.

The loonie reached $1.28 (78.1 U.S. cents) on Monday for the first time in about five months, reflecting the greater certainty of the Bank of Canada raising interest rates in the coming months, says a CIBC report.

The market is basically "scrubbing out risk of a negative outcome" that had been built in, says a BMO report outlining the new United States-Mexico-Canada Agreement (USMCA).

The deal agreed to late Sunday avoids punitive auto tariffs and preserves the Chapter 19 dispute resolution mechanism, while opening up Canada's dairy sector to U.S. products.

CIBC expects the central bank to hike rates this month, with the next hike coming in January. BMO is now calling for three hikes in 2019—January, April and July.

Still, CIBC tempers growth expectations. While the Bank of Canada imposed a 0.2 percentage-point-per-year drag on growth from trade uncertainties, the report says, "it won't lift all of that in its next forecast, given that the steel/aluminum issue remains unresolved."

For its part, BMO says the deal "heavily reduces lingering uncertainty" for the 2019 economic outlook, but the central bank will still want to see evidence of business investment and capacity before revising its GDP forecast. Since BMO assumed a deal would be reached in its base case, GDP growth forecasts now have upside potential, it says.

BMO notes that the loonie still faces challenges longer term. Broader policy changes are needed to address Canada's competitiveness, it says, so any further loonie strength will be limited.

"Prior to the deal, we were looking for 78.5 cents ($1.275) for the end of this year and 80 cents (or $1.25) for the end of 2019," says the BMO report. "We remain generally comfortable with that call."

CIBC says Canadian equities affected by the trade woes should garner some support. BMO says that support "will be more of a case-by-case basis" in areas such as auto parts, some industrial products and dairy.

Auto suppliers Martinrea International Inc. (up 11%), Linamar Corp. (up 7.6%) and Magna International Inc. (up 4.8%) saw big gains in early trading, Bloomberg reported.

BMO adds that, if the deal improves sentiment toward Canadian equities more broadly, then the gap in forward earnings yields relative to U.S. equities could narrow.

The trade deal isn't a cure-all for Canada's export sector, though, says CIBC. "Real exports from the U.S. are up 75% from 2000 levels, but Canadian real exports have seen little growth over the same period," it says.

To turn that around, the loonie must be kept range-bound or weaker over the medium turn, it says.

"That should still see the Bank of Canada trail the Fed, hiking only 50 [basis points] in total in the next few quarters," says CIBC. In contrast to BMO, CIBC says, "Look for the Canadian dollar to return to the low 1.30 range in 2019 as the BoC is outgunned by the Fed."

Good news for Canada

While the new deal isn't "a game changer," CIBC says, it avoids punitive auto tariffs and preserves the Chapter 19 dispute resolution mechanism. Chapter 19 has been historically instrumental in maintaining fair trade practices, especially in lumber. The mechanism "limits the ability of the U.S. or Mexico to impose arbitrary anti-dumping and anti-subsidy duties at their discretion," says the report.

Chapter 20, the government dispute resolution mechanism, also remains in place.

More good news: NAFTA's Chapter 11 won't apply to Canada anymore. Under that mechanism, companies from one country could sue for damages arising from policy changes affecting its investment in the other. With Mexico, Chapter 11 will be retained in some sectors—oil and gas, infrastructure and telecoms. These developments represent "the best possible outcome from the Canadian standpoint," says CIBC.

CIBC's report highlights other wins: The U.S. dropped its demand to sharply reduce access to U.S. government procurement contracts, and agreed to at least a 16-year term for the deal (with a review at the six-year mark).

And, while the U.S. could move forward with auto tariffs on global auto imports, Canada won't be affected.

"Canada has negotiated a quota for tariff-free exports of autos stateside amounting to a level that is roughly 40% higher than current exports," says the CIBC report. "That should provide a buffer for as far as the eye can see, as long as the product meets North American content requirements, which have been inflated from 62.5% to 75%."

BMO says the agreement on autos is a "net positive for Canada."

Where Canada loses

On the minus side, U.S. dairy exporters will have better access to Canadian consumers, as Canada conceded about 3.5% of its protected dairy market.

While the dairy concessions aren't popular with Canadian producers, they're potentially a benefit to consumers, says CIBC.

With dairy import quotas to be phased in over six years, the BMO report says, “Ottawa believes that the industry can gradually adjust to the changes.” Further, dairy farmers will receive compensation, to be worked out in coming months, Foreign Affairs Minister Chrystia Freeland told reporters in Ottawa Monday.

Potentially affecting Canadians’ drug costs, drug makers received an extended patent protection period of 10 years from eight years previously. The BMO report describes this portion of the deal as the one “clear negative for Canada.”

Also, Canadian retailers could face more competition from online sales, because the ceiling on goods that can be shipped across the border while avoiding tariffs increased to $150 from $20.

Tariffs still in effect

U.S.-imposed tariffs on steel (25%) and aluminum (10%) stand, as do Canada’s retaliatory tariffs. However, progress may be made on that front, says CIBC, with talks expected. Further, the U.S. agreed to give Canada and Mexico advance notice and a window of negotiation should it find new industries that it wants to subject to these so-called national security tariffs.

“Uranium has been mentioned in that regard,” says CIBC.

Have a nice and fruitful week!