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1. Weekly Markets Changes

[January 18, 2019]

S&P TSX	S&P 500	Dow Jones	NASDAQ	CAD/USD	Gold	WTI Crude
15,303.83	2,670.71	24,706.35	7,157.23	\$0.7541	\$1,282.11	\$53.80
+364.65 +2.44%	+74.45 +2.87%	+710.4 +2.96%	+418.4 +6.21%	-0.01c -0.01%	-8.14 -0.63%	+2.21 +4.28%

2. Canada's inflation rate accelerates to 2%, likely a temporary jump

[January 18, 2019] Canada's annual inflation rate accelerated to 2% last month as higher costs for airfares and fresh vegetables offset cheaper prices at the pump, Statistics Canada said Friday. A deeper dive into the numbers reveals the increase is likely temporary.

Inflation was 1.7% in November, and economists had expected the same year-over-year increase for December, according to Thomson Reuters Eikon.

In particular, the StatsCan report says Canadians paid about 22% more last month for air transportation compared to a year earlier.

CIBC director and senior economist Royce Mendes attributed the increased figure to a methodological change in the way airfares are calculated.

"There's little reason for markets to react heavily to the news," Mendes said in a report, "particularly given that the Bank of Canada's three core measures remained just a hair below the 2% target."

The average of the central bank's three core inflation readings, which leave out more volatile items like gasoline, remained just under 2% last month at 1.9%, said StatsCan.

The Bank of Canada, which aims to keep inflation between 1% and 3%, can raise its trend-setting interest rate as a way to keep inflation from climbing too high. The bank pays close attention to core inflation ahead of its rate decisions.

Last week, Bank of Canada governor Stephen Poloz kept his benchmark interest rate unchanged at 1.75% as the economy navigates what he described as a temporary period of softness created by a recent sharp decline in world oil prices.

Poloz reiterated that more rate increases will still be necessary “over time.” He has introduced five rate hikes since mid-2017 in response to the stronger economy.

In a report, BMO chief economist Douglas Porter said there’s nothing in today’s inflation data to drive the central bank off the sidelines anytime soon, though “underlying firmness” in prices keeps rate hikes “very much in play” later this year. BMO is still calling for two rate hikes this year, in July and December.

For markets, Mendes said today’s data caused the loonie to rally and bonds to sell off in the minutes after the release, but some of those moves reversed as investors began to understand that the acceleration was caused by a methodology change.

Overall, the data indicate that “underlying price pressures appear consistent with a healthy, but not overheating, domestic economy,” Mendes said in his report. CIBC calls for one rate hike this year from the central bank, in the latter half.

3. Manufacturing surge pushes U.S. industrial production up 0.3%

[January 18, 2019] U.S. industrial production increased 0.3% in December, led by the biggest surge in manufacturing in 10 months.

The Federal Reserve said Friday that manufacturing output jumped 1.1% last month, the largest gain since February 2018. Automakers drove much of the growth with a 4.7% jump in production.

Utility output slumped 6.3% amid an unseasonably warm December. Mining output rose 1.5% on increased extraction of oil and natural gas.

Overall industrial production is up 4% from a year ago.

“This was a solid report and a good finish to 2018,” said Jennifer Lee, senior economist at BMO Capital Markets.

In emailed commentary, CIBC chief economist Avery Shenfeld said the report “reinforces our view that the U.S. economy isn’t at the precipice of recession as some have argued.”

However, Shenfeld also said the jump in auto production likely won’t continue give an overall flat trend in U.S. car sales.

Capacity utilization at factories increased 0.7 points to 76.5%, a solid increase though that’s two points below the long-term average. Still, it’s a sign that companies might need to invest more in equipment and facilities.

Manufacturers have benefited from a relatively healthy economy, despite concerns about a global slowdown, a trade war between the United States and China, and the waning stimulus from President Donald Trump’s tax cuts.

Auto sales improved 0.3% in 2018 to 17.27 million vehicles sold.

Yet there are also signs that manufacturers might struggle to keep expanding. The Institute for Supply Management, an association of purchasing managers, said earlier this month that U.S. factories expanded at the weakest pace since November 2016. The survey-based index fell to 54.1 in December, a decline from 59.3 in November. Still, any reading above 50 points to continued growth.

4. Mutual fund sales deteriorate in December: IFIC report

[January 18, 2019] The Canadian mutual fund industry finished 2018 with a whimper, with net sales in negative territory and assets under management (AUM) declining, according to the latest data from the Investment Funds Institute of Canada (IFIC).

The mutual fund industry saw negative net sales of \$7.9 billion in December, which represented a further deterioration from the \$2.4 billion in negative net sales recorded in November. These recent negative performances left the industry with overall net sales of just \$109 million for the year.

Long-term funds ended the year in the red. Long-term funds had negative net sales of \$2.5 billion for the full year of 2018, on the heels of \$8.9 billion in December outflows.

Bond funds led the way lower last year, with \$6.8 billion in negative net sales for the full year. Equity funds had just \$224 million in negative net sales in 2018, whereas the balanced category was in positive territory for the year, with \$418 million in net sales. The specialty fund category was the year’s strongest performer, with \$4.1 billion in positive net sales.

In December, the balanced category was weakest, recording \$3.5 billion in negative net sales for the month, followed by bond funds at \$2.9 billion, and equity funds with \$2.8 billion in negative net sales.

Money market funds and specialty funds were the only categories to turn in positive net sales performances in December. Money markets had \$1.1 billion in December net sales, and full-year net sales of \$2.7 billion. Specialty funds closed the year with \$281 million in positive monthly net sales.

Industry assets also took a dip in December, with AUM dropping by \$51.8 billion, or 3.5%, compared with November. Total industry assets finished the year at \$1.42 trillion.

5. Central bankers lack the weapons to fight the next big recession

[January 16, 2019] If there's a serious recession on the horizon, the world's central banks may have trouble fighting it.

Central banks took dramatic and unorthodox steps to prevent economic collapse during the financial crisis. They slashed interest rates, and in the years that followed spent trillions on bonds as part of an effort to spur growth.

One decade later, global central banks are only starting to reverse those moves.

Interest rates in developed economies remain incredibly low; in some places, they're even negative. The Federal Reserve is unloading some of the bonds it bought, but central banks in Europe and Japan have not yet done so.

The question now is whether central banks waited too long to raise rates to more normal levels, leaving them unprepared for the next crisis.

"If we have a recession, I think it's going to be worse than normal," said Kenneth Rogoff, a professor at Harvard University and former chief economist at the International Monetary Fund. "It will be more difficult to respond."

Politics is also making life more complicated for central banks. In countries like India and Turkey, they've faced threats of political interference, while President Donald Trump has repeatedly criticized the Federal Reserve.

'Another blown tire'

The outlook for the global economy has dimmed significantly in recent months as trade tensions caused growth to slow in countries including China and Germany.

The International Monetary Fund and the World Bank have cut their growth forecasts for 2019, and experts warn of more pain from US interest rate hikes, trade conflicts and geopolitical risks such as Brexit.

No one expected synchronized global growth to continue forever. But actions taken by central banks over the past 10 years could limit their response to a sharp slowdown now.

"Think of a car traveling on a bumpy road with no spare tires. You really don't want to have another blown tire," said Mohamed El-Erian, the chief economic adviser at Allianz.

El-Erian said the Federal Reserve, which raised interest rates four times in 2018, is in better shape than other leading central banks. But its benchmark rate — currently set between 2.25% and 2.5% — remains historically low, limiting the room it has to cut in order to spur growth. "Even the Fed has less flexibility than in the past," he said.

The European Central Bank and the Bank of Japan are worse off. The ECB's key lending rate is 0%, while its deposit rate is -0.4%. In Japan, short-term rates have been in negative territory since 2016.

"They're very limited in what they can do," Rogoff said.

Running out of ammo

Then there's the unprecedented moves by central banks to snap up trillions of dollars worth of bonds after the crisis to support growth, a policy known as quantitative easing, or QE.

The United States only started shrinking its \$4.5 trillion balance sheet in October 2017, and still holds roughly \$4 trillion in debt securities.

While the Federal Reserve could technically start QE back up again, El-Erian said such a program would "likely be less effective in promoting sustainable growth."

Europe only ended its QE program in December after creating €2.6 trillion (\$3 trillion) in new money. Total holdings at the Bank of Japan have reached 554 trillion yen (\$5.1 trillion) last year as it remained in stimulus mode under Governor Haruhiko Kuroda. Those assets are worth more than the country's entire annual economic output.

Put simply, the central banking system is "running out of ammo," according to Ed Yardeni, president of investment advisory firm Yardeni Research.

"They may not have as much firepower or credibility next go-round," he said.

Messy politics

On top of these tough conditions are political pressures that could complicate the ability of some central banks to mitigate or respond to a slowdown.

In December, the governor of the Reserve Bank of India abruptly quit after Prime Minister Narendra Modi's government leaned on him to do more to boost the economy ahead of elections.

The rapid appointment of a former government official to take his place further stoked fears of political meddling.

Earlier last year, Turkey found itself in crisis after its central bank refused to raise interest rates despite soaring inflation, which in turn sent the lira plummeting.

The decision came after President Recep Tayyip Erdogan indicated that he wanted to take control of setting interest rates, which he described as the "mother and father of all evil."

In the United States, Trump has taken to publicly chastising Fed Chair Jerome Powell over rate hikes. Trump has even polled advisers on whether he has the legal authority to fire Powell.

"There [are] more and more examples of how central banks' independence is something that's not flying, particularly in places where you have populist leaders," Yardeni said.

Questions over political independence of central banks, combined with their relative lack of horsepower, means they might not be able to come to the rescue in a recession.

"There may very well be limits to what monetary policy can accomplish," Yardeni said. "And it may be a mistake to tell the public they can fix all of our problems."

6. Responsible investment organization calls for pension protection

[January 16, 2019] The Shareholder Association for Education and Research (SHARE), is calling on federal policymakers to adopt measures to protect workers' retirement savings.

In a letter to federal officials at Innovation, Science and Economic Development Canada (ISED), the Vancouver-based, responsible investment organization calls on the government to take action to protect workers' pensions. Among other things, it calls for amending bankruptcy law to provide courts with the power to set aside executive and director bonuses and compensation increases where a company with unfunded pension liabilities enters insolvency.

It says that courts should be able to order clawbacks "where there have been significant dividend payments, share redemptions (at minimum, repurchases from insiders) variable executive compensation and other reviewable transactions in the three to five years prior to insolvency."

The group also calls for disclosure improvements that would promote proper pension funding. "Additional corporate disclosure [...] may help to highlight pension fund solvency rates such that executives, shareholders and creditors

are focused on the funding status as a potential area of concern to be remedied,” it states.

For companies with large or persistent pension deficits, SHARE says, corporate law should be revised to “restrict or reduce dividend payments, share repurchases and variable executive and director compensation until such time as the solvency funding ratio surpasses a specified threshold.”

SHARE also recommends that the ISED codify certain director duties in corporate legislation: “In particular, the requirement that directors consider the interests of a broad range of stakeholders—including the workforce, and the environment, should be clarified.”

Finally, the letter notes that many of these same issues also need to be addressed in provincial corporate law, saying, “a coordinated approach on retirement security between the federal and provincial governments would be preferable to a piecemeal approach adopted by individual jurisdictions.”

7. Home prices in major cities down in December: report

[January 16, 2019] Canadian home prices in metropolitan areas saw widespread declines in the fourth quarter of 2018, as the Teranet–National Bank Composite National House Price Index dropped 0.3% in December, the third decline in a row.

“The Calgary index did not rise for a sixth month in a row in December. It was a fifth month in a row for Vancouver, and a fourth one for Edmonton. Weakness became apparent in Q4 for six other metropolitan areas, when only Montreal and Ottawa-Gatineau experienced home price growth,” National Bank senior economist Marc Pinsonneault says in a house price index report. This is the worst three-month diffusion for December in five years, Pinsonneault says, and National Bank analysts continue to expect a soft landing of the Canadian home resale market.

“Higher mortgage rates and tougher qualification rules are causing the cooling in most major home resale markets in Canada,” he says. “The recent increase in vacant new dwellings may also add to downward price pressure in some markets.”

The Teranet–National Bank Composite National House Price Index looks at 11 metropolitan markets.

Phil Soper, president and CEO of real estate brokerage Royal LePage, has a more optimistic view.

“While some economists are adjusting their forecast for the economy as a whole, Canada’s real estate market is beginning to emerge from the correction

that began a year ago,” he says in a statement. “The national real estate market is stable and should see modest price gains by the end of the 2019.”

Soper cites Royal LePage data from 63 Canadian markets showing that the price of a home in Canada increased 4% year-over-year to \$631,223 in the fourth quarter of 2018. “Secondary cities” such as Windsor, Kingston and Moncton outperformed larger cities, the report says.

In its forecast, Royal LePage projects modest home price appreciation in 2019, expecting the aggregate price of a home in Canada to rise 1.2% over the next year.

8. Goldman Sachs CEO apologizes to people of Malaysia

[January 16, 2019] Goldman Sachs' new CEO is apologizing for the role of a former banker in Malaysia's multi-billion-dollar embezzlement scandal.

"It is very clear that the people of Malaysia were defrauded by many individuals, including the highest members of the prior government," David Solomon said Wednesday on the company's earnings call.

Tim Leissner, the company's former chairman of Southeast Asia, has admitted to being "one of those people," he continued. "For Leissner's role in that fraud, we apologize to the Malaysian people."

Solomon's remarks come amid a crisis for the bank, which faces lawsuits and investigations tied to its job in raising money for Malaysia's sovereign wealth fund, 1Malaysia Development Berhad.

The saga hung over an otherwise solid earnings report that boosted shares up 8% in Wednesday trading.

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Goldman posted fourth-quarter results that beat analyst expectations, earning more than \$2.5 billion in the last three months of 2018. It netted nearly \$10.5 billion for the full year.

The company made \$1.2 billion in revenue from financial advisory fees alone, which jumped 56% compared to the same quarter in 2017 because of a spike in finished mergers and acquisitions across the industry.

Meanwhile, bond trading revenue plunged 18% to \$822 million. The trading division has been an ongoing headache for the bank, though trading has been a problem sector-wide this quarter. Citigroup, Bank of America and JPMorgan Chase have all shared trading desk declines this week.

This was the first quarter of results for Solomon, who took the reins of the company from Lloyd Blankfein in October. Yet concerns about 1MDB have clouded the transition.

Solomon on Wednesday said that morale at the firm remains "high" despite the 1MDB drama, though conceded that "people here are extremely angry and upset about the fact that we had a partner of the firm involved in such significant fraud."

The impact of the scandal on global business has been negligible, Solomon added. But he noted that the bank would need to take time to work through damage to its reputation.

The US Justice Department claims conspirators misappropriated \$4.5 billion from 1MDB, and has zeroed in on Goldman's role in the scheme. The Malaysian government is also ramping up pressure for Goldman to compensate the country for its losses.

The bank's involvement hinges on three large bond offerings that it arranged for 1MDB in 2012 and 2013. The bond sales, which raised a total of \$6.5 billion, earned Goldman Sachs \$600 million in fees.

In the end, almost half the money Goldman raised for the fund was allegedly siphoned off to pay for jewelry and fine art, and to fund bribes and kickbacks to foreign officials, according to US officials.

The bank has repeatedly claimed it was misled by Leissner, who left the firm in 2016. Goldman has said Leissner intentionally deceived its legal and compliance teams.

Last year, Leissner pleaded guilty to conspiring to launder money from 1MDB. He admitted that he concealed certain facts from Goldman, but he said in his guilty plea that this was in line with the bank's "culture."

Leissner's plea, as well as US charges against another Goldman Sachs banker who worked on the 1MDB deals, were revealed in November.

9. Climate is the biggest risk to business (and the world)

[January 16, 2019] Companies and investors are waking up to the dangers posed by climate change and extreme weather.

Many now consider environmental risks, such as droughts and wildfires, to be even more dangerous than turbulent markets, cyberattacks or geopolitical snafus.

Climate and environmental issues dominate a ranking of top global risks produced by the World Economic Forum ahead of its annual summit in Davos. Business leaders and experts surveyed by WEF said that extreme weather, migration caused by climate change and natural disasters are the three risks they're most likely to face in 2019.

Each of the climate-related risks also ranks among the top five issues in terms of potential impact.

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"There is more investor pressure and more requirements on companies," said John Drzik, president of global risk and digital at insurance broker Marsh. "They have been already facing pressure from consumers to make their products more climate friendly, but the amplified investor pressure is new."

Climate risks

Natural disasters and extreme weather caused around \$160 billion worth of damage in 2018, according to reinsurance company Munich RE. Control Risks, a consultancy, predicts that figure will be surpassed in 2019.

"From storms to floods to droughts and forest fires, the costs of interrupted production, distribution, sales and travel will skyrocket in 2019," the group said in its annual risk report.

Climate disasters point to several areas where businesses face increased risks. The first is supply chains. A report from University of Maryland and software firm Resilinc showed that global supply chain disruptions caused by weather doubled in 2017.

The risk doesn't affect just the developing world, where infrastructure is often weaker. Hurricanes Harvey, Irma and Maria combined that year to make the United States the most disrupted region for the first time.

The most dramatic example of a company coming under pressure from risks related to the environment is Pacific Gas and Electric.

The California utility company is facing billions of dollars in claims over the deadly 2018 Camp Fire, and it said earlier this week that it would file for bankruptcy on January 29.

The company cited at least \$7 billion in claims from the Camp Fire, which caused 86 deaths and destroyed 14,000 homes. It is believed the fire was started when a PG&E power line came in contact with nearby trees.

In the bankruptcy filing, the company cited the "significant increase in wildfire risk resulting from climate change" as one of the reasons for its decision.

"We simply wouldn't be seeing the catastrophic weather events we've witnessed in recent years if not for the amplifying effect of climate change," said Michael Mann, director of the Penn State Earth System Science Center.

Business response

Top investors are demanding that more companies draw up environmental action plans. They're also asking CEOs to consider risks to their business caused by shifting consumer attitudes toward climate change.

Alison Martin, the chief risk officer at Zurich Insurance Group, said it doesn't matter whether the company's leadership "believes in climate change or [what they think] the causes of it are."

"If you were a plastic straws manufacturer a few years ago thinking about your strategy going forward, maybe you weren't anticipating that consumer sentiment could so quickly and so radically move against you," she said.

Shareholders are becoming increasingly vocal.

Norway's \$1 trillion sovereign wealth fund launched a big push for sustainability in September, saying it will be using its power as the world's biggest stock holder to influence companies to behave more responsibly.

Last month, investors managing assets worth \$32 trillion called on businesses to step up efforts to tackle climate change.

In a landmark climate report last year, the United Nations last year called for "rapid, far-reaching and unprecedented changes in all aspects of society." It warned the world has only 12 years to avert a climate disaster.

Drzik said the UN timeline made companies wake up to the urgency.

"View of risks tends to be dominated by the short-term horizon, and climate is still seen as more long-term than geopolitical risk ... but that report has started to pull more focus on it," he said.

Maersk, the world's biggest shipping company, recently said it's aiming to be carbon neutral by 2050 and urged other shipping companies to do the same.

Last month, Shell became the first energy company to link executive pay and carbon emissions.

10. Pound strengthens after parliamentary defeat leaves Brexit plan in tatters

[January 16, 2019] The British pound shrugged off a dramatic vote in the UK parliament that left the government's Brexit plans in tatters.

Parliament on Tuesday struck down the divorce deal that Prime Minister Theresa May had negotiated with the rest of the European Union by a record margin. The defeat was expected, but the size of the loss — 432 votes to 202 — was a surprise.

The pound, which had fallen below \$1.27 earlier on Tuesday, erased its losses after the vote and strengthened to \$1.28. Some analysts had predicted the pound would rally if May suffered a major defeat because that would raise the chance of Brexit being delayed.

The crushing loss means parliament may now wield greater control over the process. Capital Economics said lawmakers could move to delay Brexit while they work on alternatives.

"Most importantly the size of the defeat appears to reduce the chances of the United Kingdom leaving the European Union without a deal," said Paul Dales, chief UK economist at Capital Economics.

Britain is scheduled to leave the European Union at the end of March. It's unlikely that the deal negotiated by May can be substantially revised before that deadline.

Some supporters of Brexit want Britain to leave the bloc without a deal. Other potential outcomes include a second referendum or the collapse of May's government and a general election. There is increasing speculation that the whole process will be delayed.

Business reaction

Business groups reacted to the vote with anger.

"There are no more words to describe the frustration, impatience, and growing anger amongst business after two and a half years on a high-stakes political rollercoaster ride that shows no sign of stopping," said Adam Marshall, director general of the British Chambers of Commerce.

Companies remain worried about the potential costs of crashing out of the European Union without a deal. The chance of that happening may have decreased on Tuesday, but business remains unnerved.

Abruptly leaving the European Union without a deal in place would mean new trade barriers and an uncertain legal environment. Business lobby groups have warned that many companies are unprepared for a messy Brexit.

The US Chamber of Commerce said in a statement that a messy Brexit must be avoided, and it urged the United Kingdom and the European Union to consider extending negotiations beyond March 29 "if necessary."

Have a nice and fruitful week!

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