Weekly Updates Issue # 556

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1. Weekly Markets Changes

[March 18, 2016]

S&P TSX	S&P 500	Dow Jones	NASDAQ	CAD/USD	Gold	WTI Crude
13,497.07 -24.93 -0.18%	2,049.58 +27.39 +1.35%	17,602.30 +389.0 +2.26%	4,795.65 +47.18 +0.99%	$0.7690 +1.19¢ +1.57%	$1,256.00 +4.90 +0.39%	$39.35 +0.86 +2.23%

2. Inflation drops to 1.4%

[March 18, 2016] Canada's annual inflation rate slowed to 1.4% in February, mostly because of a decline in gasoline prices over the same time last year. Excluding gasoline, Statistic Canada's consumer price index would have been up to 1.9% last month. Statistics Canada says food was a major inflationary factor in February, with consumers paying 3.9% more for food, compared to February 2015.

In total, six of the eight major components of the consumer price index were up. And, apart from the transportation index that includes gasoline, the only other component to decline was clothing and footwear (down 1.3%).

3. CRA tweaks interest rate for corporate taxpayers

[March 18, 2016] The Canada Revenue Agency has announced the prescribed annual interest rates that will apply to any amounts owed to the CRA and to any amounts the CRA owes to individuals and corporations. These rates will be in effect from April 1, 2016 to June 30, 2016.

There have been no changes to the prescribed interest rates since last quarter, except for the interest rate for corporate taxpayers' pertinent loans or indebtedness.

Income tax

- The interest rate charged on overdue taxes, Canada Pension Plan contributions, and employment insurance premiums will be 5%.
- The interest rate to be paid on corporate taxpayer overpayments will be 1%.
- The interest rate to be paid on non-corporate taxpayer overpayments will be 3%.
- The interest rate used to calculate taxable benefits for employees and shareholders from interest free and low-interest loans will be 1%.
- **Changed:** The interest rate for corporate taxpayers' pertinent loans or indebtedness will be 4.45%.

4. U.S. current account trade deficit hit $484.1B in 2015

[March 17, 2016] The deficit in the broadest measure of U.S. trade declined slightly in the final three months of 2015, but for the entire year the deficit jumped to the highest level in seven years.

The deficit in the current account narrowed to $125.3 billion in the fourth quarter, down 3.6% from a deficit of $129.9 billion in the third quarter, the Commerce Department reported Thursday.

The deficit for the entire year rose to $484.1 billion, up 24.3% from a 2014 imbalance of $389.5 billion. It was the biggest annual deficit since 2008 when the deficit totalled $690.8 billion.

The big deterioration reflected the struggles that U.S. companies are having as weakness in major economies overseas and a stronger dollar have sharply reduced export sales.

The current account is the broadest measure of U.S. trade because it covers not just trade in merchandise but also trade in services such as airline fares and legal fees and also covers investment flows between countries.

The rising trade deficit trimmed overall economic growth by 0.6 percentage point in 2015, a significant reduction for an economy that grew at a modest 2.4% last year, as measured by the gross domestic product.

Analysts say trade will act as a drag on growth this year as manufacturers and other exporters including farmers continue to struggle to sell their products abroad.

Trade deficits have become a major topic in this year's presidential race with Republican Donald Trump and Democrat Bernie Sanders both contending that the country has been hurt by the failure of the U.S. government to negotiate trade deals that protect American jobs from being lost to other nations engaged in unfair trading practices.

The 2015 deficit was equal to 2.7% of total U.S. economic output, up from 2.2% of GDP in 2014.

The increase in the total deficit reflected a 2.4% rise in the deficit in merchandise. U.S. goods exports dropped by 7.2%, the first annual decline in goods exports since 2009, a year when the global economy was struggling to emerge from a deep recession.

5. Would change to Home Buyers' Plan help you?

[March 16, 2016] One tool that can help people buy homes is the Home Buyers' Plan (HBP), which allows first-time buyers to withdraw up to $25,000 from their RRSPs to fund home purchases.

In this year's federal budget, tax experts expect the Liberals to loosen the requirements of the HBP. It's proposed that even if people don't meet the existing definition of a first-time homebuyer, the government may allow them to qualify under the plan if they're dealing with life events, including relocating for work, divorce or the death of a spouse.

As a result, people in those situations would be able to "dip into their RRSPs and avoid immediate tax on withdrawals," while keeping the contribution room they've generated, says accountant Stephanie Dietz. Plus, they'd have "a greater amount of funds available if [they] don't have other savings."

Using the HBP is like taking "a 15-year loan of $25,000 from the government," she adds. Homebuyers have to pay at least 1/15 of the amount withdrawn from their RRSPs each year over that 15-year period – in this case, $1,667. For any amounts not paid back, people don't pay penalties, but unpaid amounts are added to people's incomes for the year for tax purposes. They also lose that RRSP room.

Dietz notes the tax rate on any annual income inclusions would be based on people's marginal tax rates.

The benefits

Changes to the HBP would benefit divorcees the most, says Dietz. "There's the most need there," she says, since people can be put at a disadvantage if they own homes jointly.

Under current rules, it's possible for a divorced person to qualify under the HBP:

- as long as his name wasn't on the title of his former house; or
- if the title is transferred to him by the courts, as long as he doesn't occupy the home during that process or afterwards.

However, he'd have to wait four years after he moves to qualify under the HBP if he doesn't meet these conditions.

Criteria to qualify as first-time home buyer

To qualify under the Home Buyers' Plan, CRA says a person must be a Canadian resident and satisfy its definition of a first-time homebuyer. A person can meet these requirements more than once by:

- not having occupied, as a principal place of residence, a home that was bought by him or his spouse through the HBP for a period of four years, from the year of his withdrawal ending 31 days prior to the new withdrawal of his RRSP funds (e.g., if a client had wanted to make a withdrawal in November 1, 2015, he could not have owned a home at any time between January 1, 2011 and October 1, 2015); and
- making sure his HBP balance is $0, meaning all amounts owed for prior purchases have been paid back.

If he intends to use RRSP funds to build or buy a home that is more accessible for a disabled person, whether that's him or someone related to him (by blood, marriage, adoption, or common-law rules), he doesn't have to be a first-time homebuyer to access the HBP, and nor does he have to have a zero balance.

Dietz isn't sure why Canadians who are relocating for work would be included, unless the intention is to help "someone who's moving to Vancouver or Toronto, where house prices are high. If you're moving to a place where housing prices are hot, you may need to dip into your RRSP to cover the costs."

Regardless, she says, more flexible HBP rules would allow advisors to help clients decide whether or not to use their RRSPs to buy a house in these types of situations. "It'd be hard to lose by using the HBP, [given] the majority of mortgage payments go toward interest in the beginning." The tax return on interest savings can exceed potential RRSP investment returns, "unless [clients] hit the jackpot by choosing a fantastic investment."

When advising a client on his options, says Dietz, it's best to start by discussing his mortgage and the rate he's likely to get. "[Then] put together an amortization schedule [that] includes the total cost of borrowing, and the current and forecasted rate of returns in his RRSP," which will help highlight the pros and cons of using the HBP plan.

A tweak to the HBP might also encourage more RRSP contributions. If people have already used the HBP, says Dietz, they might avoid making extra RRSP contributions for fear of losing access to savings that could be used for home upgrades, for instance.

The main risk

But if clients don't have adequate retirement savings, using RRSP funds for home purchases in more scenarios is an issue. "It wouldn't make sense for a person to dip into their RRSP and get a mortgage if they don't have other assets," says Dietz.

"There's a risk they'll have to withdraw [again] to pay the mortgage and would have to pay tax on that amount. But, in that kind of situation, they might have to dip into the RRSP regardless, so it's debatable on what the best approach would be. The limit right now is just $25,000 per person, [which is] not necessarily a huge hit."

6. Three surprises from the Federal Reserve

[March 16, 2016] Most expected today's Fed meeting to be a non-event. Despite initial appearances, it didn't turn out that way.

"At first glance, you would conclude it was just a placeholder meeting because no action was taken," says Robert Spector, portfolio manager at MFS Investment Management in Toronto. "But the sub-text was that there was actually quite a bit going on."

He identifies three key points:

1.Global risks

Risk assets such as equities and corporate bonds have been trading better from February lows, notes Spector. "And government bond yields have been rising—not dramatically, but they're no longer falling."

But the Fed's statement today underlined its view that global developments continue to pose risks. "There's a feeling that the balance of risks isn't neutral, [isn't] skewed to the upside. They're still somewhat skewed to the downside."

He says one of the things the Fed has been "captive" to over the past several years is that "every time they want to be a little bit more hawkish on the rate environment, it ends up backfiring in that the dollar starts to rally, there are market strains, commodity prices come down, there's emerging market weakness, and that tightening in financial conditions then gets the Fed to back off. Then all of a sudden things look better again, the data comes in better, financial markets rally, and then the Fed comes back on the table [with a possible rate hike], and you get that loop again where things get weak."

He notes the Fed wants to raise rates this year, "but they really want to get across the view that this is going to be a very different, very muted rate cycle. And by continuing to cite these global strains, they avoid the market starting to aggressively price in rate hikes, which would then undo this recovery in markets that's been apparent the last month."

2. Inflation

Recently, some inflation readings have been creeping higher, particularly core inflation. "The Fed didn't really amp that up in the statement," notes Spector.

"I wouldn't say Chair Yellen dismissed it, but she didn't explicitly show any worry about the higher trend in core inflation in her press conference. And in the economic projections, they actually took down their expectations for core inflation versus December, which seems weird because inflation's been going up."

In short, it was surprising that Yellen didn't "elevate [inflation] as a little bit more of a concern."

3. Dots

Spector notes there was a widespread consensus among Fed watchers that the dot plot—the median projection for the federal funds rate for 2016—would show a decline from four rate hikes to three for the year. But it fell to two hikes.

"So you have three things going on that were a dovish surprise in what people thought was going to be a placeholder meeting," concludes Spector.

7. Vancouver, Toronto drive national home prices higher

[March 15, 2016] The Canadian Real Estate Association says home sales in February were up 18.7% from a year ago, as it raised its forecast for this year. The increase compared with February 2015 was driven by sales in Vancouver, Toronto and Montreal.

Meanwhile, Vancouver and Toronto also helped drive the national average price for a home sold in February up 16.4% to $503,057.

Excluding those two markets, the average price was $355,235, up 8.7%t.

On a month-over-month basis, home sales in February were up 0.8% from January.

In its new forecast for 2016, the association says it now expects sales this year to grow by 1%, compared with earlier expectations that the number of homes sold this year would contract by 1.1%.

8. Little impact if feds drop education credits

[March 15, 2016] The upcoming federal budget may introduce some tax changes for students, similar to the measures that were recently introduced in Ontario's 2016 budget. The main difference is the Liberals are only expected to eliminate two of three available education credits, versus Ontario's plan to eliminate all three in favour of a student grant program.

Currently, on the federal level, "There are three non-refundable tax credits available to students," says Curtis Davis, director of tax and estate planning at Mackenzie Investments. "These are the tuition tax credit, the education

amount and the textbook amount. For the tuition amount, there are no proposed changes," but the other two credits may be on the chopping block.
This is likely because students don't save much from claiming these two credits. And, it doesn't make sense to claim the credits until they earn more than the Basic Personal Amount, which is usually after they graduate. Curtis says, "Instead, students need money while they're in school and incurring [costs], such as tuition fees."
In place of the eliminated credits, "The Liberals [may] propose to increase the amounts awarded under Canada Student Grants," which is money that students receive while in school that they don't need to pay back.
However, says Davis, "There's no indication [the government] would claw back education credits that have been carried forward to this point. Similar to Ontario, [the government] would probably set a date as to when you can no longer claim these credits or accumulate new values."

Breaking down the benefits

Using the current education amount, students are able to claim a non-refundable credit for each month of study at an accredited institution, whether it's located in Canada or not. The credit also applies if students are registered in a cooperative or eligible training program. In all cases, they're able to receive 15% of $400 per month if they're full-time, or 15% of $120 per month if they're part-time.
Using the textbook tax credit, full-time students can save 15% of $65 for each month they're registered during the year, while part-time students only save 15% of $20 for each month they're registered.
Overall, students' tax savings aren't significant when using these two credits, says accountant Stephanie Dietz. "If you're a full-time student for eight months out of the year, you have $400 plus $65 for the two credits, multiplied by eight. And then, you multiply that total by 15% federally. That's only tax savings of $558 for a typical year, so eliminating the credits may not impact [wealthy] people's planning that much."
Still, students who don't qualify for grants would potentially receive less support if the two credits are cut, she adds. "The Liberals are moving in line with the idea that if you need assistance to pay for school, you have to qualify for a grant." This new system would help lower- and middle-income income students most, versus wealthier families where a parent pays for school and then uses the tax credits.
An alternative to getting rid of the credits would be making them refundable, says Dietz. Some taxpayers would prefer this, she says, since the current credits are easy to calculate.

Davis sees the elimination of the two credits as a plus. For most students, the move would "simply mean a small reduction in the amount of tax credits they would have to transfer to eligible [taxpayers] such as parents, grandparents and spouses," or a reduction in the amount they'll be able to carry forward.

He agrees that lower-income families would benefit the most from a move to increase student grants. "These are families that may not have as many resources available, such as personal savings, to pay [education] bills. So they might be resorting to student loans," and that debt load should be reduced. Plus, "It's possible that students from middle-class families who haven't been eligible for grants before will also benefit."

Further, all parents will still have the option of using the tuition tax credit, says Davis. "Given average tuition rates in Canada, which are at about $6,200, the tuition tax credit should still be intact and students should be able to transfer the tuition credit. For parents or spouses who are helping students, there's comfort that they may not lose all tax benefits."

9. Banks could soon take on more mortgage loan risk

[March 15, 2016] Canada Mortgage and Housing Corporation is continuing to explore the possibility of forcing banks to shoulder more of the risk associated with home mortgage loans.

During a speech in Calgary, CMHC president and CEO Evan Siddall say the option of requiring lenders to pay a deductible on mortgage insurance claims is still on a table.

According to speaking notes posted on the website of the federal housing agency, Siddall told his audience that the CMHC is working with a number of government entities, including the Department of Finance and the Bank of Canada, to examine ways of better distributing risk across the financial system.

The idea of having banks pay a deductible on mortgage insurance claims was first floated by CMHC under the previous Conservative government.

It's been unclear whether the new Liberal government is interested in pursuing the idea.

Homebuyers with less than a 20% down payment are required to obtain mortgage default insurance from either CMHC or one of the private mortgage insurers.

The Canadian Bankers Association warns the previous government that shifting more mortgage risk onto the banks could threaten the country's financial stability. The industry association laid out its position in a letter to

CMHC penned in August 2014, which was obtained by The Canadian Press through an Access to Information request last year.

The Department of Finance said last November that it had undertaken preliminary research to examine the impact of shifting more of the risk to the banks.

Siddall made his comments during a luncheon hosted by the C.D. Howe Institute, a think-tank that once called for the privatization of the CMHC.

During his speech, he defended the organization's status as a public institution, arguing that it played an important role during the 2008 global financial crisis. "As a Crown corporation with a public policy mandate, CMHC needs to be present in the market through all economic cycles. This is a fundamental way in which we contribute to Canada's financial stability. In fact, our role now in Alberta is to support continuous access for Albertans to the housing market, even if private insurers choose to pull back."

10. Ontario to test guaranteed minimum income

[March 14, 2016] An overlooked paragraph in the recent Ontario budget could mean big changes in the lives of some of the province's most impoverished residents. It proposes the idea of providing a guaranteed minimum income to such Canadians.

In chapter one of last month's provincial budget, the government says, "One area of research that will inform the path to comprehensive reform will be the evaluation of a Basic Income pilot. The pilot project will test a growing view […] that a basic income could build on the success of minimum wage policies and increases in child benefits by providing more consistent and predictable support in the context of today's dynamic labour market.

"The pilot would also test whether a basic income would provide a more efficient way of delivering income support, strengthen the attachment to the labour force, and achieve savings in other areas, such as health care and housing supports. The government will work with communities, researchers and other stakeholders in 2016 to determine how best to design and implement a Basic Income pilot."

As the budget's forward states, the development of this project is in line with Ontario's plans to "improv[e] the supports necessary to lift people out of poverty and help them live a meaningful life, to the benefit of Ontario's economy and society. Social assistance rates will increase by 1.5%, while a further top-up will be provided to those with the lowest social assistance rates."

The concept of a minimum income program is also on the radar of the federal Liberals, reports Keith Leslie of Canadian Press. So far, a Liberal-dominated parliamentary committee has called on the Trudeau government to explore the concept of guaranteeing people a minimum income in a pre-budget report tabled Friday.

Charles Sousa, Ontario's finance minister, said the province has not decided which community will be the test site for a basic income guarantee. "It's something that many people seem to have an interest in us testing out, so we're looking at something in the fall," he says. "Other jurisdictions are using it, and I want to see if it makes sense for us. So it's important for us to pilot [and] test it out, and see what happens."

Proponents say that providing a guaranteed minimum income top-up to families living below the poverty line would be more efficient and less costly than administering the existing series of social programs that help low-income residents. They say poverty is one of the biggest determinants of health, and a guaranteed minimum income could mean reduced health-care costs.

"Poverty costs us all," said Senator Art Eggleton last month, as he called for a national pilot project of a basic income guarantee. "It expands health-care costs, policing burdens and depresses the economy."

Currently, about 9% of Canadians live in poverty, but the numbers are much higher for single mothers and indigenous communities. If Ontario's basic income pilot project is designed correctly, it could help eliminate some of the "perverse incentives" that institutionalize poverty, says Danielle Martin, vice president of Women's College Hospital in Toronto.

"We want to design programs that will give people who need it income security, but will not discourage them from entering the workforce," she adds. Also, she notes, "It's entirely possible that if we design this pilot right, we [could] actually have a major impact on the health outcomes for some of the most vulnerable people in the province, and that can save tremendous amounts of money in the health-care system down the road."

Canada experimented with a guaranteed minimum income in Dauphin, Manitoba in the early 1970s. The so-called Mincome project found it did not discourage people from working, except for two key groups: new mothers, and teenaged boys who opted to stay in school until graduation.

The Mincome project also found an 8.5% reduction in hospital visits in Dauphin during the experiment, said Martin. "People had fewer visits because of mental health problems," she said. "There were fewer low birth-weight babies, so very concrete and immediate impacts in terms of people's health."

The Income Security Advocacy Centre says care must be taken to ensure no one is worse off as a result of the Ontario pilot for a basic income guarantee.

For example, people on social assistance in Ontario also get their prescription drugs and dental bills paid for, as well as help with child care, and they should not lose those benefits with a basic income guarantee, says Martin.

However, people should not be concerned that a guaranteed minimum income would mean those on social assistance are suddenly living on easy street, says Eggleton. "This wouldn't be the good life," he told the Senate. "It would provide a floor, a foundation that low-income people can then build upon for a better life."

Social programs should lift people out of poverty, not keep them there, and a basic income is a new approach that could work, adds Eggleton. "How we have dealt with poverty has failed."

Last month's provincial budget promised a pilot project to test "that a basic income could build on the success of minimum wage policies and increases in child benefits by providing more consistent and predictable support."

This concept is on the radar of the federal Liberals as well: a Liberal-dominated parliamentary committee has called on the Trudeau government to explore the concept of guaranteeing people a minimum income in a pre-budget report tabled Friday.

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Have a nice and fruitful week!